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RESERVE BANK FOR INDIA

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PREFACE

The subject, a Reserve Bank for India, has received special attention during the last ten years and, in view of the new Reserve Bank Bill of 1933, is of outstanding importance to-day. There is no dearth of literature on central banking, but opinions expressed in regard to the application of principles to Indian conditions are at times so conflicting that an ordinary reader is apt to be bewildered in the absence of a concise, clear and scientific presentation of what is admittedly a highly technical problem.

An attempt has been made in the following pages to make a lucid and unbiassed examination of the whole position with a detailed analysis of the present proposals. If the treatise is of any assistance in clarifying the clouded atmosphere which exists and in facilitating a true appreciation of the meaning and working of a Reserve Bank which is about to be established, the writer will consider his labour amply rewarded.

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October, 1933.

CHAPTER I

INTRODUCTORY

1. Meaning of A Reserve Bank.

Definition.—A study of the proposals to establish a Reserve Bank is best begun with an examination of the principles on which a Reserve Bank is, or ought to be, based. But, what is a Reserve Bank? The answer that a Reserve Bank is only another name for a Central Bank at once gives rise to two more questions : first, what is a Central Bank? and second, why should not a Central Bank for India be called a Central Bank, and not Reserve Bank?

As regards the meaning of a Central Bank, various definitions exist, but in simple words, a Central Bank may be described as ‘the people’s agency to govern their supply of currency and credit, free from any undue influence of politics or profits.’

The reason why a Central Bank for India was given the special appellation of ‘Reserve Bank’¹ by the Hilton Young Commission of 1926 (Report, para. 92) was to avoid ambiguity. For in India there are already at least four banks with names each of which suggests a Central Bank e.g., Imperial

1. The Central Bank in South Africa was also founded in 1920 under a similar title, namely, the Reserve Bank of South Africa.

Bank of India, Central Bank of India, Bank of India and Indian Bank, but none of which is in fact a Central Bank as defined in the preceding paragraph. In view of this consideration the title of Reserve Bank seems quite suitable and people have also become familiar with it since it has been used not only in the report of the Hilton Young Commission, but also in the numerous reports of the provincial and Indian Banking Enquiry Committees (1929-31) and in the proposals for the new Indian Constitution, apart from the writings of a number of economists.

2. Functions and Mechanism.

Functions.—Having noted the meaning of a Central or Reserve Bank, two simple questions must now be answered *viz.*, what does a Central Bank do and how does it do it?

According to the Indian Central Banking Enquiry Committee (1929-31), 'the two principal tasks of the Reserve Bank will be to maintain the international value of the rupee and to control the credit situation in India, which would include the rate of interest at which credit would be available to trade and industry'.¹

The Governor of the Bank of England in his evidence before the Royal Commission on Indian Currency and Finance set out the duties of a Central Bank as follows :

1. *Report of the Indian Central Banking Enquiry Committee, 1931*, para. 607.

' It should have the sole right of note issue ; it should be the channel, and the sole channel, for the output and intake of legal tender currency. It should be the holder of all the Government balances ; the holder of all the reserves of the other banks and branches of banks in the country. It should be the agent, so to speak, through which the financial operations at home and abroad of the Government would be performed. It would further be the duty of a central bank to effect, so far as it could, suitable contraction and suitable expansion, in addition to aiming generally at stability, and to maintain that stability within as well as without. When necessary it would be the ultimate source from which emergency credit might be obtained in the form of rediscounting of approved bills, or advances on approved short securities, or Government paper.'¹

Put shortly, in the words of the Macmillan Committee, a Central Bank must have four functions or rights *viz.*—

- (1) the right of note issue,
- (2) the right to hold the reserves of the commercial banks,
- (3) the right to buy and sell securities, and
- (4) the right to discount.²

1. *Royal Commission on Indian Currency and Finance*, Minutes of Evidence, vol. v., pp. 251—252.

2. *Report of the Committee on Finance and Industry*, London, 1931, (Cmd. 3897), para. 30.

Basis of the Functions.—The reason why a Central Bank must possess the foregoing four rights is not difficult to understand, if it is borne in mind that the main objective of a Central Bank is to maintain stability in the value of money or, which is the same thing, steady prices.¹ No institution can ensure in a country stability in the value of money unless it possesses requisite means to regulate the supply of currency and credit in accordance with their demand. That is what the above rights enable a Central Bank to do. How exactly they do it is the next question.

Mechanism.—It should be obvious that the twin rights of note issue and holding the reserves of the commercial banks place the Central Bank in the best position to control the existing supply of currency and credit. As the only bank of issue it has the power, broadly speaking, to expand and contract currency, as it may deem fit; while in its capacity as the custodian of the reserves of commercial banks, it occupies the position of a sovereign bank, bankers' bank or a Central Bank—a bank which is the central supervisory body to co-ordinate the activities of all banks in the country.

1. ‘The main objective of Central Banks acting in co-operation in the management of the international gold standard should be to maintain stability of international prices both over long periods and over short periods.’ (Cmd 3897, para 286.) An international gold standard does not at present exist, but the objective is still the same.

Discount Operations.—Normally a Central Bank regulates the supply of credit in two ways—technically known as *discount operations* and *open market operations* but which, in their broad outline, can be explained quite simply. Taking the discount operations first, it is one of the normal features of central banking that a Central Bank and a bill market usually go together. Wherever there is a Central Bank, the habit is well developed among producers, manufacturers and traders of obtaining credit from commercial banks not in the shape of cash credits or loans and advances, but by drawing and discounting bills. Since bills are drawn against commodities, they are ‘self-liquidating’ i.e., they automatically liquidate or turn into cash, with the sale of the commodities against which they are drawn.

On the one hand, there are producers, manufacturers and traders who have goods but want funds for the period intervening between the production or marketing of goods and their actual sale. On the other hand, there are banks whose function is to supply funds for financing industry and trade. The “self-liquidating” bill serves as the ideal link. Producers, manufacturers and traders have only to draw bills against commodities (which bills, to put the matter quite simply, are promises for payment on a future date) and the banks readily discount or cash such bills. As the bills mature or reach due date, they are presented to the drawees or acceptors and

are duly met with the cash obtained from the sale of the commodities against which they are drawn.

In a central banking system the commercial banks are assured accommodation at all times, by the simple device of re-discounting trade or produce bills with the Central Bank, should their own resources get exhausted. At the same time, an excellent opportunity is afforded to the Central Bank for controlling credit, for while the Central Bank is prepared to rediscount bills apparently without limit, it can and does raise the rate at which it will rediscount them thereby discouraging the supply of credit. On the other hand, should a Central Bank consider that circumstances require an expansion of credit, it can send a wave of ease through the market by lowering its rate of discount.

Advantages of Bills.—Dealings in bills carry with them special advantages for the suitable expansion and suitable contraction of credit from the stand-point of a Central Bank. In the words of Sir Cecil H. Kisch—

‘First, it (a bill) reveals or should reveal, to the expert the purpose for which the finance is required, thus enabling the Bank to distinguish between cases in which money is being sought for speculative purposes and those in which it is required for furthering the production or marketing of goods. Again a bill is drawn for a stated amount, and has a stated date of maturity when it must be met. The fact that a bill

has a definite maturity enables a Bank to regulate its purchases according to its particular requirements from time to time. The degree of definiteness attaching to a bill as a formal document places it in a different category from a cash credit or advance, which, whatever time limit may be assigned to it in the first instance, is liable to continue under the pressure of the borrower for extended periods. Further, a bill is capable of endorsement by a theoretically unlimited number of parties, and the addition of other signatures to that of the acceptor, especially if they include a bank of established credit, converts the promise to pay of a single firm or individual into guaranteed paper of first-class quality. Lastly, a bill is a negotiable instrument, and when endorsed in the manner just indicated will be assured of ready marketability, so that it provides one of the requirements essential to the assets of a Central Bank, namely, that of free convertibility into cash. It is for these reasons in the interest of a Central Bank to encourage the development of an active bill market by every means in its power.¹

Open Market Operations.—While the discount operations are the usual means by which a Central Bank regulates the volume of credit with a view to maintaining a stable value of money or steady prices, it is conceivable that this method may fail if

1. *Central Banks* by Sir Cecil H. Kisch and W. A. Elkin, 1932, pp. 129-130.

the commercial banks at any time do not follow the lead of the Central Bank. And this may well happen, if the banks have large resources of their own and go on expanding credit even when the Central Bank's reading of the situation calls for a curtailment and the Bank accordingly puts up its discount rate. If the banks ignore it, the Central Bank may be helpless.

To avoid such a contingency, a Central Bank is given the right of open market operations or direct dealings with the market, when the indirect dealings—through banks—will not do. In simple language, if the Central Bank's object is to curtail credit and the commercial banks fail to raise their rates with a rise in the Bank rate, all the Bank need do is to sell in the open market securities or bills which it holds, thereby transferring to itself the funds which are available to the commercial banks, until they are reduced to the necessity of seeking accommodation from the Central Bank. On the other hand, if an expansion of credit is desired and the commercial banks will not take their cue from a fall in the Bank rate, the Bank may buy securities or bills in the market thereby releasing funds and making them available on easy terms.

The objection usually advanced against open market operations is that it puts the Central Bank in the position of an unfair competitor of commercial banks, but it is a reserve power given to the Central

Bank for making its policy effective in the wider interests of the nation. Such a power, in fact, may not be used, for its mere existence may be sufficient to persuade the commercial banks to follow the lead given by the Central Bank.

3. Safeguards and Restrictions.

Safeguards.--It should by now be clear that a Central Bank has very wide powers in the realm of finance for it is charged with the supreme duty of maintaining stability in the value of money or a steady price-level and, therefore, equipped with the sole right of note issue coupled with the custody of the nation's ultimate cash reserves—both governmental and banking. A Central Bank is thus both a Bankers' Bank and a State Bank in the sense that it serves both the banks as well as the State. But it is more. It is the Nation's Bank which exists for the larger service of the nation, sectional interests having no place in it. This fact will explain the importance which attaches to the proper constitution of a Central Bank, for an ill-conceived Central Bank can be a source of much national harm, just as a well-planned Central Bank is an asset of great national good.

A study of the different constitutions of Central Banks of the world shows that a Central Bank, if it is to run strictly on lines of prudential finance and in national interests, must be adequately safe-

guarded from all undue influence of politics or profits, from sectional influences whether of institutions or individuals, and particularly from all extraneous and foreign influences.

Restrictions.—In view of these considerations it is usual to impose various restrictions on a Central Bank from which ordinary banks are free. In the first place, to save a Central Bank from the irruption or interruption of changing politics it is expedient to exclude from its management both government officials and members of the legislature.

In this regard, the position must be made perfectly clear. The ultimate responsibility for the stability of national currency must, of course, rest with the national government. But in the interests of such stability itself, it is best that the regulation of currency and credit is in the hands of a bank free from governmental control.

'The net work of financial and commercial life is so intricate, and the decisions of the Bank on important points have such widespread results, that all interests are not affected in the same way. A change in the rate of discount, for example, which benefits some may be unwelcome to others. But if the Government has a controlling influence over the Bank, there are obvious ways by which the more powerful interests in the country can try to enforce their wishes. The road is open for political intrigue, and there can be no safeguard that the policy of

the Bank will be carried on without bias as national interests require. It seems a paradox that when the object is to secure the execution of a national policy this should not most readily be achieved by the creation of a State Bank under official control ; but even in the countries where the capital of the Bank is held by the State, steps have been taken in certain instances to remove its administration from political influences and to give it a measure of independence from the Government.¹

This does not, however, preclude governmental representation on the Board of Management of the Bank in any shape or form, though the Bank of England has no Government nominee on its directorate. If some governmental representation is found necessary in view of the duties which the Central Bank performs for Government, it should be provided in such a manner as to ensure the freedom of the Bank from undue political pressure of any kind in its day to day administration.

Again freedom from undue political pressure should not be taken to imply, as is sometimes done, that membership of a political party or holding a political office is a disqualification *for all times*. As a matter of fact, Directors in the Bank of France 'are almost invariably men who have held high political office.'² The mere word 'political' is not

1. Kisch & Elkin, *op. cit.*, pp. 22-23.

2. *Colonial and Foreign Banking Systems* by Keith le Cheminant, 1924 p. 110.

tabooed, what matters is to ensure freedom from the undesirable influences of changing party politics or of the Government.

Secondly, with a view to keeping a Central Bank free from the temptation of profits, limits are imposed on the dividends that it can declare and also on the nature of its business. For instance, it is common practice that a Central Bank receives deposits without interest. The reasons for such a restriction are well set out in the following extract taken from the report of the Chilean Commission of 1925.

'A Central Bank which must be ready at all times to meet emergencies either in the form of the withdrawal of gold from its reserves—the central gold reserves of the country—or of demands for rediscount from member banks, must of necessity keep large reserves. If it is to keep large reserves and it is to be administered with primary reference to public service, it must not feel under the necessity of keeping its funds out at interest in order to be able to pay interest on deposits. A Central Bank which pays interest on deposits would need to have a larger field of operations with the public than is given by this bill to the Central Bank of Chile, and such an enlargement of its field of operations with the public would make the Bank a strong competitor of other banks.'

The deposits of the Central Bank will be of three kinds :—

- (1) Demand deposits representing the legal reserve money of other banks.
- (2) Demand deposits of the Government.
- (3) Demand deposits of the public.

The first class, namely, demand deposits representing the legal reserves of member banks clearly do not call for interest. Such deposits of reserve money take the place of cash now held in the vaults of those member banks which does not now earn interest. The second class, namely, demand deposits of the Government, likewise do not call for interest. Most of them will be active check accounts. Government funds calling for permanent or long term investment do not properly belong to the Central Bank. It should be noted, moreover, that the Government's large participation in the profits of the Bank, both as stockholder and as recipient of the progressive franchise tax provided for in Article 99, assure it a fair share of any profits that may be realised by the Bank from Government deposits.

As to interest on deposits made by the public, your Commission believes that it would be unwise to permit the Central Bank to compete with member banks for interest-bearing deposits. The field of interest-bearing deposits should be left exclusively to commercial banks and savings-banks.'

Thirdly, in order to safeguard a Central Bank from sectional influences, such interests are not, as a rule, allowed to have direct representation on

the Board of Management. For instance, it is undesirable for representatives of joint-stock banks to be Directors of the Central Bank, for the latter control the credit policy of the nation, while the former are primarily interested in making profits for the shareholders. Joint-stock banks would naturally always favour credit expansion and it would be hard for their representatives to give unbiased counsel to a Central Bank when it is a question of contracting credit.¹

Fourthly, to ensure freedom from all foreign influences, the constitutions of Central Banks, more often than not, restrict Directorship and voting and even shareholding rights to nationals. In the case of the Central Banks of Belgium, Bulgaria, Estonia and Germany it is laid down in their Charters that all the Directors must be nationals, while the Central Bank of Czechoslovakia is permitted to have one additional Director who may be a foreigner, and in Austria, Columbia and Chile the number of foreigners as Directors is carefully restricted. Again, in the case of the Central Banks of Denmark, France, Greece and Netherlands the voting rights are exercised by nationals only, while in Japan and Switzerland

1. The South African Reserve Bank started its existence with the inclusion of a few representatives of joint-stock banks, but within a couple of years the provision had to be amended so as to exclude them. In certain countries the law provides for the representation of commercial banks on the Central Bank directorate, but in all such cases the number of such directors is carefully restricted.

even the holding of shares is restricted to nationals. The Charter of the Central Bank of Lithuania provides that foreigners cannot hold more than one-third of the capital.

Freedom from foreign influence must not, however, be taken to preclude cultivation of relationships with foreign Central Banks.¹ International co-operation must, indeed, be in future the basis of national prosperity, and a Central Bank's capacity for national service must be in the proportion in which it can generate international good will and international confidence.

Room for Research.--Once the main safeguards are provided for, the Central Bank constitution must not be too rigid, but left as flexible as possible and permitted to develop sound traditions of its own, suited to the particular needs and prospects of the country. In fact, while there is agreement on broad principles, the theory of central banking is of recent origin and its technique is still capable of improvement. It would be as foolish not to derive full advantage from the past experience of other countries as not to seek fresh light in new experiments and research.

1. The Bank of England has a special department to deal with this work and there is an increasing tendency in recent times of frequent exchange of visits between Governors and higher officials of Central Banks.

CHAPTER II

NEED FOR A RESERVE BANK IN INDIA

1. Present Position of Indian Currency and Credit.

General Observations.—Having seen what a Central Bank is and what it does, the next question which arises is: why is such a bank needed in India? The answer naturally turns on the functions of a Central Bank. Broadly speaking, a Central Bank correlates the demand and supply of currency and credit or the media of purchasing power and does it in a way in which no other agency has yet been found to do as well.

In India at the present time, the agency for the control of currency is the Government itself, and credit is under no effective control, but is influenced, in so far as it is influenced at all, by the policy and practice of the Imperial Bank of India ‘which to a large extent is dominated by Government’.¹

As regards currency control, the position must be viewed both from the side of demand and of supply. The demand for currency naturally arises from, and changes with, the requirements of trade and industry;

1. *Experts' Memorandum, Indian Banking Committee Report*, 1931, p. 618.

and no government, however efficient, can be in a position to gauge it so easily and so well as a bank which is the very life-breath of all trade and industry. But even if a government could make a satisfactory estimate of changes in the demand for currency, government lacks the specialised banking apparatus and is by nature so slow and unresponsive to quick change that it can hardly be expected to regulate supply in accordance with fluctuations in demand with the same efficiency and rapidity as a banking institution.¹

Inelasticity of Indian Currency.—It is, therefore, not a matter for surprise if inelasticity is one of the major evils from which the Indian currency system suffers at the present time. According to the Royal Commission on Indian Currency and Finance, ‘the system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent on the will of the currency authority.’²

Nor is there effective provision for meeting seasonal variations, so prominent in an agricultural country like India, due to the requirements for financing the movements of crops. It is true that with this end in view, Section 20 of Act X of 1923 (amended in 1924) entitles the Imperial Bank of India to receive funds up to 12 crores of rupees

1. *A Reserve Bank for India and the Money Market* by B. E. Dadachanji, 1931, pp. 17–18.

2. *Report of the Royal Commission on Indian Currency and Finance*, 1926, para, 21.

against self-liquidating *hundis* or trade bills, but it is a great defect that emergency currency cannot be issued until interest rates are at a certain level. Secondly, it is difficult to find an adequate supply of such bills, because they are not drawn in large numbers. Trade in India is generally financed by means of cash credits or promissory notes—not *hundis* or bills.¹ Thus it is one of the curious features of the Indian currency situation that, in spite of the readiness of Government to issue emergency currency with a view to relieving financial stringency in busy seasons, the financial stringency has often remained unrelieved.

Again, as the Royal Commission pointed out, 'a well-regulated system should provide for a measure of elasticity in the expansion of currency in case of great financial crisis, when the need for additional cash for the support of credit is urgent. In such cases it is necessary to provide for an emergency issue of currency on special terms. The Indian system makes no express provision of the sort'.²

Lack of Confidence.—At the same time, the issue of governmental agency does not usually inspire public confidence. This is specially the case in India. Public agitation consequent upon large contractions of currency during 1926-27 and 1930-31 is a matter within

1. For further details on the subject see my *Indigenous Banking in India*, 1929, pp. 179-181.

2. *Report of the Royal Commission on Indian Currency and Finance*, 1926, para. 19.

recent memory. The public mind was much exercised, and the President of the Indian Chamber of Commerce, Calcutta, in his letter dated 26th November, 1930, to the Honourable Finance Member, Government of India complained that ' manipulations of various kinds have been resorted to with a view to create artificial stringency and unjustified high money rates in India'.¹ On the 3rd February, 1931, Lala Rameshwar Prasad Bagla asked the following question in the Legislative Assembly : ' Is it a fact that manipulations of various kinds were resorted to by Government with a view to maintain and thereby justify the eighteen pence ratio ? ' The Honourable Sir George Schuster, Finance Member, replied, ' Government in their capacity as currency authority, and in order to maintain stability of the exchange value of Indian currency, have taken measures of the kind normally employed by currency authorities in all countries with stabilised currencies.'²

Danger of Inflation.—While in India the complaint during 1926-30 was in regard to undue contraction (' deflation ') of currency, experience in most countries has shown that governmental note issue is usually open to the danger of undue expansion (' inflation '), in times of financial difficulties. The present economic depression all over the world,

1. *Report of the Indian Chamber of Commerce, Calcutta, for 1930*, p. 194.

2. *Legislative Assembly Debates, India (Official Report)*, 3rd February, 1931, p. 551.

therefore, makes it specially imperative that governments should be spared the temptation of printing too much currency. In this connection the following observations of the Irish (Free State) Banking Commission are pertinent :

'Mindful as it is of the disasters of past years in all countries where currency was issued by the Government, and recognising the hazards which come from changes of Government, from the development of budget deficits and other evils from which no country has found itself immune, the Commission is definitely of the opinion that the management of the legal tender note issue should be placed in the hands of a non-political and independent body, which shall control the conditions of issue and shall have full control and custody of the securities it holds.'¹

Position of Credit.—Turning from currency to credit, the position is somewhat peculiar. India is not altogether lacking in the elements which go to make up a sound banking system. There do exist in the country indigenous bankers, co-operative societies, commercial banks, exchange banks, savings banks, investment securities, even some bills of exchange and two stock exchanges,² but they are all ill-developed and lack co-ordination.

1. Quoted by Kisch and Elkin, *op. cit.* p. 74.

2. A fuller treatment is given in my *Monetary Problems of India*, 1933.

The banking reserves of the country are scattered among various agencies with no mechanism for their mobilisation, while credit, as already pointed out, is divorced from currency. This is perhaps the greatest weakness of the banking system in India, and is responsible for the evils of fluctuating and high rates of interest. An annual range of three per cent. in interest rates is unheard of in other countries, but is quite ordinary in India and exercises a detrimental influence on the economic life of the country.¹

Some people seem to imagine that high rates of interest naturally follow from seasonal stringency. But, as the foreign experts rightly point out, this is a wrong conception. 'It is one of the principal tasks of a properly managed and well organised Reserve Bank to tide over busy periods when money is in strong demand without unduly raising the bank-rate. The absence of a mechanism, which by expanding credit can meet the seasonal demand for money, is mainly responsible for the variation in the bank rate.'²

2. Need for a Central Mechanism.

Utility of a Central Bank.—The foregoing analysis of the present currency and credit position in India proves the need for a Central Bank which is the best mechanism yet devised for the efficient

1. *Experts' Memorandum, Indian Banking Committee Report, 1981*, p. 648.

2. *Ibid.*

control of currency and credit. At present the various financial units in the country are isolated and form in the aggregate a mere conglomeration. They all need to be developed and organised, but they also need a rallying-point such as a Central Bank alone can supply. The utility of a Central Bank for India has been fully established as a result of various governmental inquiries during the last decade.

Recent Recommendations.—The credit for the first definite and strong recommendation for the establishment of a Central Bank in India must go to the Hilton Young Commission (1925-26). The Commission presented a considered scheme which was accepted by Government and put in the form of a Reserve Bank Bill in 1927, followed by another Bill in 1928. But the two Bills, which are examined in the next chapter, did not become law.

The question was taken up afresh in 1929, when a comprehensive banking inquiry was held all over the country to study the whole existing banking structure to which a Reserve Bank might be suitably adapted and added. The Committee observed : 'It is the unanimous opinion of all authorities on the subject that the first step to remove many of the defects in the existing system is to bring the Reserve Bank into being. The foreign banking experts went so far as to say that it is one of our principal duties to recommend that the Reserve Bank

should be established in India as soon as possible and that this institution should be free from political influence.'¹

The Federal Structure Sub-Committee of the First Round Table Conference recommended that, 'with a view to ensuring confidence in the management of Indian credit and currency.... efforts should be made to establish on sure foundations and free from any political influence, as early as may be found possible, a Reserve Bank, which will be entrusted with the management of the currency and exchange.'²

The Financial Safeguards Committee of the Third Round Table Conference regarded the establishment of the Reserve Bank as a condition precedent to the inauguration of the new Constitution—a view with which prominent Indian public men like Sir Tej Bahadur Sapru do not agree—and recommended 'that steps should be taken to introduce into the Indian Legislature a Reserve Bank Bill conceived on the above lines as soon as possible.'³ In the Report of that Committee it was also placed on record that 'The Secretary of State undertook that representative Indian opinion would be consulted in the preparation of proposals for the establishment of the Reserve Bank including those relating to the

1. *Report of the Indian Banking Committee*, 1931, p. 605.

2. *Second Report of the Federal Structure Sub-Committee* (15th January, 1931), para. 18.

3. *Report of the Committee on Financial Safeguards*, 1932, para, 4.

reserves.' A Committee was accordingly set up in England (July, 1933) and its recommendations form the basis of the new Reserve Bank Bill of 1933 which is examined in detail in the last chapter.

3. Principal Problems and Suggested Solutions.

Conditions for Success.—Before the above mentioned Bills are examined in the remaining chapters, something may be said in regard to the conditions for the successful working of a Central Bank in India. The principles enunciated in the first chapter make it abundantly clear that the constitution of a Central Bank must be technically sound. But that alone is not sufficient. Two other general conditions must be satisfied. First, without departing from the essential principles a Central Bank must be so planned as to suit the economic conditions and satisfy the economic needs of the country. Secondly, a Central Bank must be such as to command the confidence and good will of the Indian people.

However technically sound a Central Bank may be, it would entirely fail in its purpose if it did not satisfy the economic needs of the people or if it did not enjoy their fullest confidence. This must have been in the minds of the present Finance Member and his illustrious predecessor when they gave expression to the following sentiments with which all will agree.

'At one stroke,' said Sir Basil Blackett in 1927, 'control of Indian currency and finance will be trans-

ferred from a centre situated at some point between White Hall and Delhi into sole control of India. And while geographically the control will be in India, the atmosphere in which that control will be exercised will be no longer a Governmental atmosphere but an atmosphere permeated by the views of representatives of agricultural, commercial and industrial India.'

In winding up the general discussion on the New Reserve Bank Bill in the Legislative Assembly on the 14th September, 1933, the Honourable Sir George Schuster stated that the Bank 'must become a trusted part of Indian public life,' that 'it must be an Indian institution commanding the confidence of Indian opinion, otherwise the whole purpose of the proposal would be lost,' and that he wished to launch the scheme with the maximum of support from Indian opinion.

Problem of Long Areas and Wide Distances.—In special economic circumstances of the country, the first important problem is that of wide areas and long distances. India, in point of area, is over 19 times as large and in point of population nearly eight times as big as Great Britain and Northern Ireland. The area of India is 1,800,000 sq. miles, while the population according to the latest Census figures is 353,000,000 as against 125,000,000 in U. S. A., and 375,000,000 in the whole of Europe except Russia¹. If a unitary

1. *India in 1930-31*, p. 145.

Central Bank is set up in India, it will have to deal with member banks as wide apart as Karachi and Rangoon *i.e.*, about the distance which separates London from Constantinople.

Further, the geographical conditions and needs of one part of the country are not the same as those of another. They require separate and special treatment. It would, therefore, seem that among the Central Banks of the world the most appropriate model for India to follow would be the Federal Reserve System of the United States of America *viz*, a number of Regional Banks with a central organisation. The proposal of a Central Bank with five local boards in five areas, however, may be feasible, provided the local boards have greater discretion than is contemplated in the latest proposals.¹

Problem of Indigenous Banking.—Another important problem concerns indigenous money lenders and bankers. Whatever the defects of these indigenous credit agencies, they conduct the most numerous credit transactions in the country and it is now unanimously agreed that their extinction is neither desirable nor practicable.² The only right course is to organise them and bring them within the orbit of central banking operations. The question is undoubtedly full of difficulties, but if indigenous banking is not effectively linked up with modern banking, the

1. See below, p. 68.

2. For a discussion see *Indigenous Banking in India*, 1929.

Reserve Bank will be a partial failure. Some useful suggestions on the subject are available in the report of the Indian Banking Enquiry Committee to which reference is made at the appropriate place in the last chapter.¹

Problem of Normal Functioning.—Yet another difficulty is that the normal functioning of a Central Bank presupposes the presence of a well organised bill market, but such a market does not exist in India, at present. The difficulty can, however, be overcome in several ways. In the first place, the Central Bank may be permitted to grant loans and advances on the security of the promissory notes of scheduled banks, supported by documents evidencing title to goods which have been transferred, assigned, hypothecated or pledged to any such bank as security for credit granted for *bona fide* commercial or trade transactions or for purposes of financing seasonal agricultural operations or the marketing of crops.² In the second place, as suggested by foreign experts, the Bank 'may be allowed to make loans and advances on the security of movable goods, wares and merchandise, as well as against the warehouse warrants or warehouse receipts representing such goods.'³ In the third place measures should be taken for the development of a bill market.

1. See below, pp. 80–81.

2. See below, pp. 72–73.

3. *Experts' Memorandum. Indian Banking Committee Report, 1931*, p. 652.

It may be hoped that the establishment of a Reserve Bank would in itself stimulate the development of the bill market in the country, inasmuch as it would dispel the present prejudice on the part of joint-stock banks against the discounting of bills and increase their utility and importance. For just as a bill market is essential for central banking operations, the latter are so valuable to the bill market. One really helps in developing the other. The following are other suggestions made by the Indian Banking Enquiry Committee (Report, para. 593) for the development of a bill market.

(a) When the Reserve Bank is established, it should use its discretion to charge a higher rate for demand loans against authorised securities and at the outset, it may find it useful to have a larger margin between these rates than will be necessary after the bill market has developed.

(b) Establishment of warehouses.

(c) Abolition of stamp duty on bills within a period of five years. As an initial step the duty on all bills of less than one year's usance should be reduced to a uniform rate of two annas per Rs. 1,000.

(d) Standardisation of customs *re hundis* in particular regions, if not for the entire province.

(e) Expeditious procedure for disposal of suits based on negotiable instruments on the lines of Order XXXVII of the Civil Procedure Code in places where *hundi* business is important.

(f) Joint efforts on the part of commercial bodies and Government in various directions to encourage the use of bills.

Four Special Requirements.—Finally, according to the Financial Safeguards Committee of the Third Round Table Conference, four special requirements are necessary before in its opinion, a Reserve Bank can start with a reasonable chance of success. The requirements are: a satisfactory Indian budgetary position, reduction in the existing short debt in India and in London, adequate reserves and restoration of India's normal export surplus.

Taking these one by one, the budgetary position of India is not unsatisfactory. The revised estimate for 1932-33 indicates a realised surplus of Rs. 217 lakhs, while the budget for 1933-34 is expected to close with a surplus of Rs. 25 lakhs,¹ the large surplus in 1932-33 being provided for, as there was a deficit in the preceding year. Again, it can be stated on the authority of the Finance Member that the second and third requirements *viz.*, reduction in existing debt and adequate reserves are also satisfied.² But the same cannot be said in regard to the fourth requirement.

The figures of India's balance of trade during recent years make sad reading. It is not quite clear

1. *Budget Volume* for 1933-34, p. 99.

2. *Legislative Assembly Debates, India* (Official Report), September, 1933.

what the Financial Safeguards Committee meant by the restoration of India's *normal* export balance. Taking the average of the 10 pre-war years ending 1913-14 the balance of trade in merchandise was Rs. 71·74 crores, while the figure for the average of 10 years ending 1929-30 *i.e.*, before the recent economic depression, was Rs. 83·13 crores.¹ If the Committee had either of these surpluses in mind while using the expression *normal* export balance, it may safely be predicted in the present conditions of trade that such a surplus may not be restored in the near future. But in 1932-33 the balance was Rs. 3·38 crores only. A balance of Rs. 3 crores as compared with the pre-war or pre-depression balances of Rs. 72 crores and Rs. 83 crores is so low that whatever the meaning of a normal surplus, it can never be regarded as satisfactory.

If by a normal export balance we mean a trade balance sufficient to enable government to meet its large sterling requirements in London, these requirements average about Rs. 40 crores per annum. A balance sufficient to cover these requirements as also private remittances is indispensable, if a Reserve Bank charged with the task of governmental remittance operations is to effect a smooth transfer of the required funds from India to England. Should such a surplus not be available, the Bank will be hard put to it and will have to bear a strain which it

1. *Report of the Controller of the Currency* for 1932-33, p. 47.

should not be called upon to bear at least in the very initial stages of its existence.

The balance of trade in merchandise (private) has been Rs. 35 crores and Rs. 3 crores in 1931-32 and 1932-33 respectively—amounts obviously unsatisfactory for coping with the governmental sterling liabilities, but the large exports of gold (Rs. 58 crores in 1931-32 and Rs. 66 crores in 1932-33)¹ have taken the place of other commodity exports and have come to the rescue of governmental finance.

This is an impossible situation. How long can it last? Assuming that the price of gold will continue to be high—by no means a certain proposition—the gold holdings of the people which economic forces can compel and high profits can tempt them to part with are not unlimited. Gold exports at best postpone the evil. When they cease, a situation of the gravest character will arise if things are allowed to drift in the hope of a world recovery which is not yet in sight, and which judging from the present prospects of world co-operation, seems to be advancing further into the future.

Limitations of a Central Bank.—Finally a word may be said in regard to the limitations of a Central Bank. Extremely useful though a Central Bank is, some people imagine that it is, or should be, ‘a cure-all for economic ills: that it should somehow completely stabilize commodity prices, prevent bank

1. *Report of the Controller of the Currency* for 1932-33, p. 47.

failures, suppress speculation, and eliminate the fluctuations of the business cycle.¹ But these evils have occurred in spite of the increasing number of Central Banks in the post-war period. The causes of these evils are numerous—monetary and non-monetary—into which we need not enter, but it may be recognised that even the Central Banks have their limitations. At the same time, with the progress of prudential banking and with increasing international co-operation the evils can to a great extent be avoided or their rigour materially mitigated.

1. *The Reserve Banks and the Money Market* by W. R. Burgess,
1927, p. 5.

CHAPTER III

THE SCHEMES OF 1927 AND 1928

1. General Observations.

The Bill of 1927.—The schemes for a Reserve Bank put forward by Government in 1927 and 1928 are contained in the Reserve Bank Bills of those years. The first Reserve Bank of India Bill¹ was published in the Gazette of India Extraordinary on the 17th January, 1927 and introduced in the Indian Legislative Assembly on the 25th January. It was referred to a Joint Select Committee of both the Assembly and the Council of State; and the Committee reported on the 18th August, several members, Sir Basil P. Blackett included, appending minutes of dissent. The bill as amended by the Select Committee was taken up in the Simla Session of the Assembly, but its consideration was suspended on the 8th September owing to lack of agreement on the question of the Bank's Directorate².

The Bill of 1928 and Back to Previous Bill.—On the 1st February, 1928 Sir Basil Blackett, the

1. Its full title was 'Gold Standard and Reserve Bank of India Bill,' but attention is confined to the Reserve Bank scheme here.

2. For a full discussion, see *Legislative Assembly Debates, India* (Official Report), 1927, Vols. iv and v, pp. 3556—85, 3738—3856, 3905—06, 4180, 4242, 4277—92.

then Finance Member, sought to introduce a new Bill, as a result of his cold weather (1927) consultations with the India Office. The President of the Assembly did not permit the Bill to be introduced since the previous Bill of 1927 was already before the house.¹ Government, therefore, proceeded with the former Bill and tried to pass it with certain amendments, but the Bill broke down on the clause concerning the Board of Management. Government insisted—quite rightly according to the generally accepted principle of sound central banking—that the Central Bank of the country should be free from all political influence.² Indian opinion was equally insistent that in the peculiar conditions of the country and with the Governmental mistakes of 1920 still fresh in the public mind, representation of the Indian legislature on the Central Bank of the country should not be altogether absent. This deadlock ended the Bill.

It may be useful, however, to compare and contrast the main provisions of these unfortunate Bills.

2. Capital, Management and Business.

Object.—The object of both the Bills, as stated in their preambles, was the same *viz.*, to secure ‘stability in the monetary system of British India.’ This was, of course, in complete accord with the

1. *Legislative Assembly Debates, India* (Official Report), 1st February, 1928, Vol. i, pp. 73—77.

2. Kisch and Elkin, *op. cit.*, p. 61.

conception of a Central Bank as outlined in the first chapter.

Duration.—As was suggested by the Hilton Young Commission (Report, Para 141), both the Bills proposed to give the Bank the sole right of note issue for 25 years in the first instance, subject to renewal.

Capital.—The Bill of 1927 provided for an initial capital of rupees five crores divided into shares of five hundred rupees each fully paid-up. Of the original capital the Imperial Bank of India (not the shareholders, as was recommended by the Commission¹) was to have the option of subscribing thirty per cent. and the remainder, together with any shares not taken up by the Imperial Bank under this option, was to be offered for public subscription. In case the full amount of share capital was not subscribed, the deficiency was to be made up by the Governor-General in Council taking shares at par and

1. The Commission had recommended that the Imperial Bank's shareholders should be given the first opportunity of subscribing to the capital stock of the Reserve Bank as a consideration for foregoing important privileges which the Imperial Bank had hitherto enjoyed. But a clear-cut division of functions between the Reserve Bank of India and the Imperial Bank of India being the essence of the proposal creating a Reserve Bank, it was felt undesirable to give the shareholders of the Imperial Bank a preponderate voice in deciding the currency policy of the Reserve Bank. It was, therefore proposed to give the Imperial Bank as an institution and not to its individual shareholders the option of subscribing three-tenths of the capital. It was, however, open to the bank to distribute the allotment among its shareholders, if it so desired.

subsequently disposing of them by sale to the public within three years.

The share capital of the Bank could be increased by the Board of the Bank with the previous sanction of the Governor-General in Council.

For the following reasons given in the Committee's own words the Select Committee favoured a Bank with capital supplied by Government to a bank with private share capital.

'In the first place, it was thought that a banking institution the primary object of which was the control of the credit and the finances of the country would, if directed by a body responsible only to a number of private shareholders, tend to be controlled by vested interests, and would therefore, fail to secure the confidence of the Indian public; and that its utility to the public might even be endangered by a conflict of interest within the management of the Bank between Indian and external capital.'

Secondly, we consider that joint-stock principles are not suitable in the case of a Central Bank the management of which should be carried on with an eye more to the public interest than to the accumulation of profits for shareholders.' (Committee's Report, p. 1.)

Sir Basil P. Blackett with seven other members dissented from the rest of the Committee and their reasons for preferring the original plan of privately subscribed share capital were bound up with the ques-

tion of the constitution of the Directorate of the Bank (see below, pp. 43 *et seq.*). At the same time, they observed that if the whole of the capital of the Bank were subscribed by the Government, it would become 'very difficult to ensure that complete independence for the Bank which is essential to its proper working.' (*Minute of Dissent* p. 1.)

The question was fully debated in the Assembly.¹ Apart from the points already stated, the opponents of the shareholders' scheme argued that the shareholders in reality took little interest in management and left it to directors ; that a Reserve Bank did not require much capital and there was no need to create a body of shareholders simply for the purpose of giving them vested interests, and that if a shareholders' bank did not exclude non-nationals there might be a drain of India's wealth in the shape of interest charges ; and there would also be a risk of interested direction of the Bank's policy in favour of foreign capitalists and foreign industries at the expense of Indian trade and industry.

It was urged on behalf of Government that the experience of central banking in recent years was wholly in favour of a shareholders' bank and that wherever orthodoxy on fundamental principles had been abandoned, endless and highly dangerous

1. *Legislative Assembly Debates, India* (Official Report), 1927. Vol. iv., pp. 3649—3692.

troubles had arisen. The force of the objection against a shareholders' bank on the ground that foreign capitalists might direct the policy of the Bank against the true interests of India was realised and Sir Basil P. Blackett gave the following definite assurance :

' May I say that I shall be perfectly willing to add to the draft amendments I have that no one who is not an Indian or a British subject ordinarily resident in India should have vote.'¹

The Bill of 1928, while retaining the share capital of Rs. 5 crores, was intended to meet the wishes of the Indian legislature in several ways. In the first place, with a view to avoiding the concentration of capital in a few hands and ensuring its distribution as widely as possible the Bill laid down that no person, whether individually or jointly, was to hold bank shares worth more than Rs. 20,000, and preference was to be given to applicants for a single share of Rs. 100.

Five Circles.—Further the country was divided into five circles *viz.*, Bombay, Calcutta, Madras, Rangoon and Delhi serving the following areas and sharing the capital indicated against each.

(a) Bombay—the Presidency of Bombay (including Sind), and the Central Provinces (Rs. 150 lakhs).

1. *Legislative Assembly Debates, India (Official Report)*, 30th August, 1927, Vol. iv., p. 3659.

- (b) Calcutta—the Presidency of Bengal and the provinces of Bihar and Orissa and Assam (Rs. 150 lakhs).
- (c) Madras—the Presidency of Madras and the province of Coorg (Rs. 40 lakhs).
- (d) Rangoon—the province of Burma, and the Andamans and Nicobar Islands (Rs. 40 lakhs).
- (e) Delhi—the remainder of India, including the territories of Indian Princes and Rulers in India (Rs. 120 lakhs).

In the event of shares assigned to one circle not being fully taken up on the first allotment, the Board, could, with the previous sanction of the Governor-General in Council, transfer a portion of such shares from one circle to another.

In the second place, in order to prevent the shares from passing into the hands of foreigners, shares were to be allotted only to Indians, British subjects domiciled or ordinarily resident in India and Indian Corporations or British Companies with a branch in India.¹

Shares Fully Paid.—In both the Bills the shares were to be fully paid. It is usual for the commercial

1. The exact words were : A company registered under the Indian Companies Act, 1913 or a society registered under the Co-operative Societies Act 1912, or a scheduled bank, or a corporation or company incorporated by or under an Act of Parliament or any law for the time being in force in any of His Majesty's dominions and having a branch in British India.

banks to have their shares partly paid-up, so that unpaid capital constitutes a special reserve in times of need, but such a reserve is unnecessary for a Central Bank whose transactions are of the safest kind and which has ample statutory reserves. Moreover, the need of unpaid capital can arise only in times of crises, and it would be most undesirable for a Central Bank itself to call money on its partly paid-up capital at a time, when other banks and the people wanted more funds.

Head Office and Branches.—The Bill of 1927 provided for the establishment of the Head Office of the Bank in Bombay as recommended by the Commission (Report, para 97)—and of branches in Calcutta, Madras and London with power to open other branches or agencies in India or elsewhere. The Bill of 1928 added two more branches, *viz.*, Rangoon and Delhi, in view of the proposed creation of new circles, the Rangoon branch having been recommended by the Joint-Committee as well. At the same time, the power of opening additional branches outside India was made subject to the previous sanction of the Governor-General in Council.¹

Management.—The general superintendence of the affairs and business of the Bank was to be entrusted to a Board of Directors and following the

1. The Joint Committee had recommended such sanction to be necessary in the case of all additional branches whether in India or elsewhere.

recommendations of the Royal Commission (Report, paras 95 and 96), the Bill of 1927 excluded from the directorate of the Bank, Government officers, members of the Indian legislature, both central and provincial and representatives of commercial banks.

The Board of Directors, according to the Bill of 1927, was to comprise a Governor and a Deputy Governor appointed by the Governor-General in Council for a period of five years, nine Directors elected by the shareholders (of whom two were to represent business interests in Calcutta and two in Bombay, one in Madras and two others to represent business interests in the rest of British India), three Directors nominated by the Governor-General in Council (representing the interests of commerce, industry and agriculture respectively), and an Officer of Government appointed by the Governor-General in Council (entitled to attend meetings and speak but not to vote).

The Select Committee which considered the Bill did not agree to the provision prohibiting members of the Indian or local legislatures from being nominated or elected as Directors of the Bank. The Committee was of opinion that 'a provision of this kind would deprive the public of the services of a considerable number of those who are versed in public affairs and finance' and did not, 'subscribe to the view that a member of the legislature would by reasons only of occupying that position, be unable to

fulfil his duties as a Director of the Bank.'

After considerable discussion 'the Committee eventually favoured the view that, of the proposed fifteen Governors, three should be elected by the elected members of the Central Legislature, and three by those of the Provincial Legislatures, because the said elected members represent together all the various interests of the people as a whole: and it is reasonable and just that on the Reserve Bank of the country there should be some Governors elected by such general electorates, in addition to those who will be elected by the Chambers of Commerce and the provincial Co-operative Banks, which bodies represent special interests.'

Instead of members of the legislatures the Committee sought to exclude all persons unless they were, or had at some time been, actively engaged in agriculture, commerce, finance or industry. Such a provision is not uncommon in the constitution of Central Banks. At the same time, while agreeing to the desirability of excluding Directors of other banks the Committee provided that 'there should be no bar to the inclusion in the Board of Directors of Co-operative Banks. Above all, the Committee was anxious to evolve a scheme 'which ensures a majority upon the Board of Indian elected members.'

The Select Committee's considered scheme was as follows:—A Governor and a Deputy Governor *of whom one shall be an Indian*, two Directors both to

be Indians nominated by the Governor-General in Council, two Directors elected by the Associated Chambers of Commerce, two Directors elected by the Federation of Indian Chambers of Commerce, one Director elected by the provincial co-operative banks, three Directors elected by the Indian legislature, three Directors elected by the local legislatures and one officer of the Government appointed by the Government.

Sir Basil P. Blackett, along with several other members, dissented from the inclusion of members of legislatures on the Bank Directorate. In their opinion, if the Bank was to carry out its policy on lines of prudent finance, 'it must not merely be expressly released from control by the Government and the Legislature, but must be free both from the risk of political pressure and from the appearance of being subject to such risk. The presence on the Board of members of the Legislatures appears to us incompatible with this fundamental principle.' After full consideration they felt convinced that the device of private share capital which was well understood and had worked well in other countries which had had to solve the problem of establishing an independent Central Bank, was the method best calculated to serve India in this connection. They were, therefore, for a restoration of the share capital basis and for the election of at least a considerable proportion of the directors by the shareholders. At the same time,

they were willing to adopt some of the ideas of the Select Committee, such as the inclusion of a few Directors elected by chambers of commerce and the provincial co-operative banks, but they were against the provision that either the Governor or the Deputy Governor and the two Directors nominated by the Government must always be Indians. That appeared to them to be objectionable, both as intruding racial and communal questions in a sphere where they ought not to operate and as subordinating the essential requisite of maximum efficiency to other considerations.

The foregoing considerations largely influenced the composition of the Board in the Bill of 1928, namely :—a Governor and two Deputy Governors appointed by the Governor-General in Council on the recommendation of the Board, four Directors nominated by the Governor-General in Council, two Directors elected by the Associated Chambers of Commerce, two Directors elected by the Federation of the Indian Chambers of Commerce, one Director elected by the provincial co-operative banks (with shares of not less than five thousand rupees), eleven Directors elected on behalf of the shareholders, in an ingenious manner described below, and one Government official nominated by the Governor-General in Council.

The eleven Directors referred to in the preceding paragraph were to represent the various circles (see

above, p. 38) in the proportion enumerated in brackets against each, *viz.*, Bombay (3), Caleutta, (3), Madras (1), Rangoon (1), and Delhi (3) and were to be elected by 92 delegates, specially elected by shareholders for this purpose and distributed as follows :—

Bombay 24, Calcutta 24, Madras 10,
Rangoon 10 and Delhi 24.

The election of the delegates was broad-based inasmuch as they were to be elected by all shareholders registered in a circle for a period of not less than six months immediately preceding the election, no shareholder having more than one vote. A delegate was to hold shares of a nominal value of five thousand rupees or more.

Business.—The Bills specifically laid down the business which the Reserve Bank might transact and the business which it might not transact. Taking the former category first, the Bank was allowed to receive non-interest-bearing deposits from Government as well as from private persons. Inclusion of the latter was recommended by the Select Committee and provided for in the Bill of 1928.

Further with a view to providing credit facilities generally and for agriculture specially, the Bill of 1928 empowered the Bank to purchase, sell and rediscount bills of exchange and promissory notes drawn and payable in India with the maturity of ninety days—six months in case (b)—from the date of purchase or rediscount exclusive of days of grace,

bearing the signature of a scheduled bank—or of a provincial co-operative bank in case (b), and one or more other good signature—not necessary in case (c)—and

(a) arising out of *bona fide* commercial trade transactions,

(b) drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops, provided that the total face value of bills or notes so purchased or rediscounted shall not at any time exceed one-fourth¹ of the total face value of all bills and notes purchased or rediscounted by the Bank up to that time.

(c) drawn or issued for the purpose of holding or trading securities of the Government of India or a Local Government.

Both the Bills empowered the Bank to deal in currencies of foreign countries with a gold standard, to deal in bills of exchange with ninety days maturity drawn in or on any place in any such country, and to keep balances with banks in such countries, but in the opinion of the Select Committee the Bill of 1927 gave too wide a discretion and the Bill of 1928 confined the above dealings to such gold standard countries ‘as the Governor-General in Council may designate for the purpose’.

Although England was expected to be the only

1. In the Bill of 1927, it was *one-fifth*, but the Select Committee raised it to one-fourth in view of India being predominantly an agricultural country.

country to be notified immediately, the course of Indian trade with other countries might necessitate the sale of some other currency and if so, other countries could be similarly notified.

Recognising the fact that owing to the lack of bills of exchange at present it might be difficult for the Reserve Bank to assist other banks in providing necessary credit facilities the Bill of 1928 provided for the making of loans and advances, repayable on demand¹ or on the expiry of fixed periods not exceeding ninety days against the security of not only (a) stocks, funds and securities (other than immovable property) in which a trustee is authorised to invest trust money by any Act of Parliament or by any law for the time being in force in British India; (b) gold coin or bullion or documents of title to the same; (c) such bills of exchange and promissory notes as were eligible for purchase or rediscount by the Bank; (d) such bills of exchange as were eligible for purchase by the Bank under the preceding paragraph; but also for a period of five years against (e) promissory notes of scheduled banks or provincial co-operative banks supported by documents evidencing title to goods which had been transferred, assigned, hypothecated or pledged to any such bank as security for a cash credit granted for *bona fide* commercial or trade transactions, or for the

1. The words *repayable on demand* did not occur in the Bill of 1927.

purpose of financing seasonal agricultural operations or the marketing of crops.

Both the Bills permitted the Bank to make advances to Government for Ways and Means purposes provided that the whole of the advances were repaid not later than at the end of the quarter following the close of the fiscal year in respect of which the advances were made.

The Bills further empowered the Bank to issue demand drafts and bank post bills on its own branches ; to purchase and sell securities of not more than five years maturity of gold standard countries specified by the Governor-General in Council ; to purchase and sell securities of the Government of India or a Local Government or a local authority in British India under certain conditions ; to have the custody of monies, securities and other articles of value ; to sell and realise all property which might come into its possession in satisfaction of any of its claims ; to act as agent for Government for specified purposes ; to purchase and sell gold coin and bullion ; to open an account with, and act as an agent or correspondent of another Central Bank of a gold standard country ; and to borrow money under certain limitations so as not to compete with other banks for fixed deposits.

Finally the Bills gave the Bank power to operate in the bill market so as to enable the Bank to fulfil its responsibility for conserving the money market and for enforcing its discount policy. But to

prevent indiscriminate competition with commercial banks, the Bill of 1928, as suggested by the Select Committee, required that open market operations could be undertaken only with the express approval of the Board of Directors and when considered necessary in the interests of Indian trade or commerce or for the purpose of enabling the Bank to perform any of its functions under the Act.

The Bills precluded the Bank from doing the following business :

(a) to engage in trade or otherwise have a direct interest in any commercial, industrial, or other undertaking, except such interest as it might in any way acquire in the course of the satisfaction of any of its claims : provided that all such interests should be disposed of at the earliest possible moment;

(b) to purchase its own shares or the shares of any other bank or of any company, or grant loans upon the security of any such shares;

(c) to advance money on mortgage of, or otherwise on the security of, immovable property or documents of title relating thereto, or become the owner of immovable property, except so far as might be necessary for its own business premises and residences for its officers and servants;

(d) to make unsecured loans or advances ;

(e) to draw or accept bills payable otherwise than on demand ;

(f) to allow interest on deposits or current accounts.

3. Relations with Government and the Money Market.

Relations with Government.—Following the recommendations of the Royal Commission (Report, para. 140) both the Bills provided as follows :—

(a) The Bank shall undertake to accept money for account of the Secretary of State in Council and the Governor-General in Council and to make payments up to the amount standing to the credit of their accounts respectively, and to carry out their exchange, remittance, and banking operations, including the management of the Government of India Debt, on such conditions as may be agreed upon.

(b) The Governor-General in Council shall undertake to entrust the Bank, on such conditions as may be agreed upon, with all his money, remittance, exchange and banking transactions in India and elsewhere and, in particular, to deposit free of interest all his cash balances with the Bank.

Exception was made, however, in the case of Government carrying on money transactions and holding balances at Government treasuries or sub-treasuries at places where the Bank might have no branch or agency.

(c) The Governor-General in Council and each local Government (words in italics added in the Bill of 1928) shall undertake to entrust the Bank, on such conditions as may be agreed upon, with the management of the public debt and with the issue of any

new loans.

Note Issue.—Following the recommendations of the Royal Commission (Report, paras 141 *et seq*) both the Bills entrusted the Bank with the sole right to issue bank notes in British India of various denominations (not excluding one rupee notes subject to the sanction of the Governor-General in Council) guaranteed by Government and based on the proportional reserve system with a provision permitting the temporary suspension of the reserve requirements on payment of a tax.¹

For the purposes of note issue the Bank was to have "The Issue Department" separate and wholly distinct from the banking business to be conducted in "The Banking Department".

Purchase and Sale of Gold.—The bills laid on the Bank a definite obligation in regard to the purchase of gold and the sale of gold and gold exchange so as to ensure the effective working of a gold standard.²

Relations with Banks.—In both the Bills every scheduled bank was required to maintain with the Reserve Bank a balance of $7\frac{1}{2}$ and $2\frac{1}{2}$ per cent. of its demand and time liabilities respectively. The Select Committee was in favour of keeping the number of scheduled banks as large as possible. It observed : we consider, however, that, if the Reserve Bank is

1. For details, see Clauses 19-30 of the 1927 Bill and Clauses 22-33 of the 1928 Bill.

2. For details, see Clauses 35-37 of the 1927 Bill and Clauses 38-40 of the 1928 Bill.

to exercise its proper control over the credit system of the country, this obligation must be extended as widely as possible and should fall upon every bank of any standing or importance doing business in British India. This is in effect a reversion to the actual proposals of the Royal Commission."

Relations with the Imperial Bank.—The Reserve Bank was to have the following relations with the Imperial Bank of India :

(1) The Imperial Bank was to be the sole agent of the Reserve Bank at all places in British India having a branch of the Imperial Bank and no branch of the Reserve Bank.

(2) The Imperial Bank was to get a commission of one-sixteenth of one per cent. on the first 250 crores and one-thirty-second of one per cent. on the remainder of the receipts and disbursements dealt with annually on account of Government by the Imperial Bank of India on behalf of the Reserve Bank.

(3) The Imperial Bank, provided it did not reduce the number of its branches existing before the establishment of the Reserve Bank, was to have the following balances from the Reserve Bank:

(a) during the first five years—3 crores free of interest;

(b) during the next five years—2 crores free of interest and at the option of the Imperial Bank up to 1 crore at 2 per cent. per annum;

(c) during the next five years—1 crore free of

interest and at the option of the Imperial Bank up to 2 crores at 2 per cent. per annum;

(d) during the next five years—at the option of the Imperial Bank up to 3 crores at 3 per cent. per annum.

4. The Imperial Bank could open a new branch only with the approval of the Reserve Bank.

4. Miscellaneous.

As usual, the Bills contained provisions also in regard to reserves, allocation of surplus, publication of Bank rate, audit, weekly returns and annual accounts, liquidation and power of the Board to make regulations.

The provisions given below in regard to the reserve fund followed the recommendations of the Royal Commission (Report, para 100) except that it was considered unnecessary to build up the reserve fund as quickly as the Commission had suggested.

After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds, and such other contingencies as are usually provided for by bankers, and after payment out of the net annual profits of a cumulative dividend at the rate of five per cent. per annum on the share capital, the surplus shall be allocated as follows:—

‘(a) one-half to a Reserve Fund, until such Reserve Fund is equal to one-half of the share

capital, and the remaining one-half to the Governor-General in Council ;

‘(b) thereafter, until the Reserve Fund is equal to the share capital, one-tenth to the Reserve Fund, and the balance to the Governor-General in Council, and

‘(c) when and for so long as the Reserve Fund is not less than the share capital, a portion to an additional dividend to the shareholders calculated in a manner so as not to exceed 2 per cent.’ (The Commission had recommended 3 per cent.)

‘Provided that, so long as the Reserve Fund is less than the share capital, not less than fifty lakhs of rupees of the surplus, or the whole of the surplus if less than that amount, shall be allocated to the Reserve Fund.’

CHAPTER ..

THE SCHEME OF 1933

1. General Observations.

Origin.—The present proposals regarding the Reserve Bank, as contained in the Reserve Bank of India Bill of 1933, emanate from the Committee on Indian Reserve Bank Legislation which the Secretary of State for India convened in London in July, 1933, and which consisted of 23 members *viz.*, Sir Reginald A. Mant (Deputy Chairman), Sir George Schuster, Sir Henry Strakosch, Sir Cecil Kisch, Sir Campbell Rhodes, Sir Edward Benthall, Sir Feroze Sethna, Sir Akbar Hydari, Sir Purshotamdas Thakurdas, Sir Cowasjee Jehangir (jun.), Sir V. T. Krishnamachari, Rai Bahadur Lala Ram Saran Das, Mirza M. Ismail, Mohd. Yamin Khan, Chaudhri Zafrulla Khan and Messrs. H. Denning, L. J. Kershaw, S. D. Waley, N. N. Anklesaria, C. C. Biswas, H. P. Mody, A. Ramaswami Mudaliar and A.R. Iyengar, with Messrs. G. H. Baxter and A. T. Williams as Secretaries.

The report of the Committee was unanimously signed by all its members at the India Office on the 1st August, 1933 and was released for publication simultaneously in India and England on the 16th August. It is somewhat unusual to find that the name

of the Chairman does not appear anywhere in the report and that he should remain unknown to the public.

The Bill of 1933.—The new Reserve Bank of India Bill which was introduced in the Indian Legislative Assembly by the Honourable Sir George Schuster on the 8th September, 1933 and on his motion referred to a Joint Select Committee of the Assembly and the Council of State, is based on the recommendations of the Reserve Bank Committee referred to above. But the Bill of 1933 is not, as is sometimes thought, a mere replica of the Bill of 1928. In a number of matters it does follow its immediate predecessor, but in several others—by no means unimportant—there are differences. The position will be clarified as we proceed to examine and comment upon its salient features.

Public Opinion.—Public opinion, as voiced in Indian papers,¹ commercial circles,² and in the Indian legislature³ is very critical of the new scheme and generally views it with disfavour and suspicion. It is well known that just as Sir Basil P. Blackett had

1. Vide editorials on the subject in the *Leader*, the *Tribune* and the *Hindustan Times* of August 18, 1933.

2. Mr. N.R. Sircar in his presidential speech at the Second Quarterly General Meeting of the Bengal National Chamber of Commerce (24th August, 1933) remarked : 'Speaking for myself, the proposals do not command my complete confidence nor inspire much enthusiasm.'

3. Vide general debate—e.g., speeches delivered by Messrs. Vidya Sagar Pandya and Gaya Prasad Singh and R. B. Mathura Prasad—in the Legislative Assembly and in the Council of State, Simla Session, September, 1933.

to proceed to England in the winter of 1927 for planning a Reserve Bank Bill, Sir George Schuster had to undertake a similar journey in the summer of 1933 for a similar purpose. London co-operation must be welcome, but the representative character of the London Committee has been questioned and it is commonly held that the Bill of 1933 in its present form does not assure the establishment of a Central Bank which shall be free from undesirable foreign influences and work with a single eye to the national interests of the country. Whatever the merits of the scheme, it is a mere truism to state that there is nothing so prejudicial to the successful working of a Central Bank as an atmosphere of discord and distrust and such an atmosphere has got to be dispelled.

Peculiar Preamble.—Turning to the Bill itself, it opens with a preamble which seeks to make it clear that, while the Bank is to start on the basis of the existing monetary system—or lack of system, for the word 'system' is hardly appropriate to describe present conditions¹—that basis is only temporary and a permanent basis will have to be devised as soon as the international monetary position has become sufficiently clear and stable to make it possible to consider the question of the monetary standard best suited to India.

In view of the present controversy in regard to

1. See my *Monetary Problems of India*, 1933, pp. 39 et seq.

the existing monetary situation in India¹ and the uncertain character of the monetary outlook throughout the world deepened by the failure of the World Economic Conference, it is very doubtful whether the present is the appropriate time for India to have a Reserve Bank with a constitution which might before long need substantial alterations, as a result of changed circumstances or in the light of a careful analysis of unusual conditions through which the whole world is passing in recent times. In this connection it is pertinent to observe that the New Zealand Parliament has only recently postponed consideration of its Reserve Bank Bill.

Commencement and Duration.—Judging from Section 1 of the Indian Reserve Bank Bill, however, it looks that the Governmental plan is to have the Bill passed into an Act within the next three months of the present year. While the wisdom of its commencement in 1933 is open to doubt, the period of duration as 'twenty-five years and thereafter until repealed' is a useful provision for two reasons. On the one hand it is intended to assure the Bank of a fairly long lease of life in which to carry out a continuous monetary policy and to build up healthy and useful traditions. On the other hand, it gives the legislature an opportunity—desirable in the case of a new institution—to take stock of the position after a number of years and revise the terms of the

1. *Monetary Problems of India*, 1933, pp. 39 *et seq.*

Charter in the light of accumulated experience.

The spirit of this provision is, however, in conflict with the preamble of the Bill which envisages changes within the next few years. The provision is thus robbed of its value by the fact that the Bank will start with the certainty of an interruption in the very beginning of its career.

2. Capital, Management and Business.

Share Capital.—The first important feature of the new Bill is the provision that the capital of the Bank will be subscribed by shareholders. This accords with the Bill of 1928, but not with the wishes of Indian public as voiced in the Select Committee (see above, p. 36) or in the Legislative Assembly Debates and accepted by Sir Basil P. Blackett, the then Finance Member on behalf of the Government.¹

Various arguments advanced for and against the shareholders' bank are noted in the preceding chapter (pp. 36-38) and need not be repeated here. It may be pointed out, however, that whatever the merits of a shareholder's scheme, it is wrong to hold that the only sound basis for the formation of a Central Bank is that its capital should be subscribed by shareholders. The foreign experts associated with the Indian Banking Committee in 1931 were quite clear on the point that a Reserve Bank could be run on sound lines whether it was formed as a

1. *Legislative Assembly Debates, India (Official Report) 1927, Vol. IV, pp. 3781—3782.*

State Bank or a Shareholders' Bank.¹

But the main point of Indian opposition to the shareholders' scheme is the fear of 'conflict of interest within the management of the Bank between Indian and external capital.' Should this fear be removed, Indian opinion can be reconciled to the advantages of the share scheme (see above, p. 37-38). The Bill of 1928 went a good way in this direction by providing shares of Rs. 100 each, preferential allotment being given to applicants for a single share, by preventing a person from holding shares either individually or jointly worth more than Rs. 20,000 and by giving the right of only *one* vote to every shareholder irrespective of the amount of the shares held. These provisions were calculated to guard against concentration of capital in a few hands and to encourage its distribution as widely as possible.

The Bill of 1933 provides for shares of Rs. 1,000 each,² places no maximum limit on the amount of shares an individual may hold, and permits the right of a maximum of ten votes to one shareholder exercisable in person or by proxy. The Bill of 1928 rigorously limited the power of voting by proxy, in order to ensure that the policy of the Bank should not be

1. *Report of the Indian Banking Committee, 1931*, p. 419.

2. It is true that the shares are of Rs. 500 each, but to be a shareholder one must ordinarily hold 2 shares of Rs. 1,000. (Clause 4 of the Bill). In the opinion of the Reserve Bank Committee, the minimum voting qualification should be two shares, (*Report*, para 4.)

easily susceptible of control by any combination of special interests. Under the new Bill, an individual shareholder can exercise as many as ten votes of his own (one vote for every Rs. 1,000 worth shares), as well as ten votes each of other shareholders as their proxy. The position is pretty serious, when it is borne in mind that attendance of the shareholders at their general meetings is usually poor.¹

In support of the proposed measures the Reserve Bank Committee observes : ' We have borne in mind the importance of securing the representation of the economic life of India as a whole, while at the same time guarding against undue influence in the affairs of the Bank by sectional interests acquired through the control of voting power.'

But these are exactly the considerations which should suggest that in this regard the provisions of the 1928 Bill are better than those of 1933, and that the latter should give way to the former.

1. For instance, at the General Meeting of the shareholders of the Imperial Bank of India held at Calcutta, 'in 1921, only 11 shareholders were present, 9 Directors and Managing Governors, and only 2 gentlemen from outside out of 5,000 shareholders. In 1922 at Bombay, there were 33 present in person and 881 were present by what they call proxy. In Madras in 1923, 41 were present in person and 1,621 were present by proxy. In 1924, at Calcutta, 16 were present in person and 908 were present by proxy. In 1925, at Bombay, 34 were present in person and 841 were present by proxy. In 1926, at Madras, 13 were present in person out of 5,000 shareholders, while 788 were present by proxy.' *Legislative Assembly Debates, India* (Official Report), 1927, Vol. iv., pp. 3652-3653.

No shareholder should be given the right of more than one vote, and it should be clearly laid down that no shareholder should vote as proxy on behalf of more than a prescribed number of shareholders. Further, as is the case in many Central Banks of the world (see above, pp. 14-15), the bulk of the shares—say three-fourths—must be reserved for nationals.

The argument of the Committee against the restriction on the amount of capital to be held by any one shareholder is that 'such a restriction would place undesirable obstacles in the way of free marketing of the shares.' The restriction would, of course, prevent the unlimited holding and free marketing of shares among the very rich, but if the net be thrown wide, experience has shown everywhere that a Central Bank's shares always rank high and are the most easily marketable of all shares.

Five Circles.—Following its predecessor, the new Bill also provides for the division of India into five circles *viz.*, Bombay, Calcutta, Delhi, Madras and Rangoon serving the following areas and sharing the capital indicated against each.

(1) Bombay—Western Area—consisting of the Bombay Presidency including Sind, the Central Provinces, Berar, Hyderabad, Baroda, Khairpur, the Western India States, the Central India States (including Makrai but excluding Rewah and other States of Bundelkhand and Baghelkhand), the Gujarat

States, Kolhapur and the Deccan States (Rs. 165 lakhs).

(2) Calcutta—Eastern Area—consisting of the Bengal Presidency, Bihar and Orissa, Assam, Sikkim, Manipur, Cooch-Behar, Tripura, the Eastern States, Rewah and other States of Bundelkhand and Baghelkhand, and the Khasi States (Rs. 165 lakhs).

(3) Delhi—Northern Area—consisting of the United Provinces, Delhi, the Punjab, the North-West Frontier Province, Ajmer-Merwara, Baluchistan, Kashmir, the Punjab States excluding Khairpur, the Simla Hill States, Dujana, Pataudi, Kalsia, Rampur, Tehri-Garhwal, Benares, the Rajputana States including Palanpur and Danta, Gwalior, Khaniadhana, Kalat, Las Bela, Hunza, Nagir, Amb, Chitral, Dir, Phulera and Swat (Rs. 80 lakhs).

(4) Madras—Southern Area—consisting of the Madras Presidency, Coorg, Mysore and the Madras States (Rs. 50 lakhs).

(5) Rangoon—Burma Area—consisting of Burma, the Andaman and Nicobar Islands, Bawlake, Kantarawadi, and Kyebogyi (Rs. 40 lakhs).

It will be noticed that in the above areas, Indian States fall in their natural geographical divisions, and are not lumped together in the Delhi area, as was the case in the Bill of 1928. This is an improvement, because different regions have different requirements and natural geographical divisions will obviously facilitate the adequate meeting of those requirements.

The allocation of shares between the various areas is of course based on their size, population and importance of interests comprised therein. In the event of the shares assigned to any area not being fully taken up on the first allotment, provision is made for the transfer of a portion of such shares from one area to another.

Board of the Bank.—Another special feature of the Bill is a small Board for the Bank consisting of eight Directors representing the shareholders (see below, p. 68), four Directors nominated by the Governor-General in Council under the present Constitution and by the Governor-General at his discretion under the new Constitution : one Governor, and one or two Deputy Governors with no voting power appointed by the Governor-General after consideration of the recommendation of the Board of the Bank, and one officer of Government with no voting power.

According to the orthodox principles of central banking, it is undesirable that the Indian legislature should be qualified for Directorship, but the conditions of India are peculiar. The monetary policy of the Government, particularly in recent years has not generally commanded public approbation ; and, whatever the reasons, it is undeniable that the proposed Reserve Bank scheme does not inspire public confidence. But public confidence, as Sir George Schuster is rightly of opinion, is the most essential ingredient

for the sucessful establishment of the Reserve Bank (see above, p. 25).

It may, therefore, be worth while securing public approval by providing for two Directors on the Board elected by the elected members of the Indian Legislative Assembly—not necessarily from among themselves. At the same time no violence will be done to the orthodox principles of central banking, if it is definitely laid down that such Directors like the Government official shall be for the purpose of tendering advice but shall not vote. They would serve as the connecting link between the Bank and the general public just as the Government official is the link between the Bank and the Government. The necessity of such Directors from the poin' of view of the public is specially great during the 'l period when all other Directors would owe their appointment to Government and it is likely to terminate with the replacement of the First Directors. This must, however, be left for future determination.

Again the Bill of 1933 makes no specific provision for the representation of Indian commercial and agricultural interests, or means to ensure an effective majority of Indian elected members. Since the Bill of 1928 did not provide for the latter, it caused some misgivings, but that Bill did provide for two Directors elected by the Associated Chambers of Commerce, two Directors elected by the Federation

of the Indian Chambers of Commerce and one Director elected by the provincial co-operative banks.

This would obviously be a better provision in the peculiar circumstances of the country than the one in which representation of commercial bodies is left to be secured by nomination in the discretion of the Governor-General.

The chief merit of the proposed Board is its small number. Within the limits of about the same number, however, it is possible to have a Board consisting of eight Directors elected by the shareholders, a Governor and a Deputy Governor, two Directors elected by the two Chambers of Commerce respectively, one Director elected by the co-operative banks, two Directors nominated by the Governor-General on the proposal of the Finance Minister to represent the general economic interests of the country, two Directors elected by the elected members of the Legislative Assembly not necessarily from among themselves and one officer of the Government—the last three having no power to vote.

Governor and Deputy Governor.—The office of Governor is undoubtedly of great importance to a Central Bank. The powers of the Governor of a Central Bank and the influence which he exercises in shaping the course of policy can be hardly exaggerated. He holds in his hands to a large, if not absolute, degree the financial destinies of a nation, and usually he is, or ought to be, an institution in himself.

The Report on the Central Bank of Chile states that the holder of this responsible office should be endowed with special qualities, viz., 'judgment, tact, broad economic knowledge, initiative, energy and executive ability.' In addition he must also be a person of tested banking experience. The same considerations should apply to the Deputy Governor who may act for and in time rise to the position of Governor.

For a suitable appointment of these officers it is necessary that the choice should not be restricted, but should be made from as wide an area as possible. At the same time, in no country is it usual for the Governor of a Central Bank to be other than its national. In order to allay all fears on this score and to maintain the policy of ensuring opportunities to Indians for training in the highest offices it must be provided that at least one of the two—Governor or Deputy Governor—if not both, shall be of Indian nationality. And in making the first appointments to posts in the Bank the appointing authority must see that preference is given to Indians and that at least 75% of the highest posts are reserved for them. The appointments of the first Governor and the Deputy Governor should be made, as the Bill requires, by the Governor-General, but after consideration of the recommendations of the Board of the Bank. Future appointments might be made by the Board of the Bank subject to the Governor-General's approval.

Local Boards.—A Local Board is to be constituted for each of the five areas (pp. 62-63) consisting of five members elected from amongst themselves by the shareholders registered in a particular area and not more than three members nominated by the Central Board. The elected members of the Local Boards are to elect from amongst themselves eight Directors to the Central Board as follows: Bombay Calcutta and Delhi Areas--two Directors each, and Madras and Rangoon areas—one Director each.

According to the Bill (Clause 9) ‘A Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it and shall perform such duties as the Board may, by regulations, delegate to it.’

In order that the economic needs of the various areas may be adequately satisfied, the Local Boards should not have merely advisory or agency functions, but should be given real powers and discretion subject to the general control and supervision of the Central Board (see above, p. 26). Nomination by the Central Board of three members to each Local Board is already provided and should ensure smooth and careful working.

Head Office and Branches.—The present Bill provides for the Head Office of the Bank to be located in Bombay with branches in Calcutta, Madras, Rangoon and Delhi. It would be of course undesirable for the Reserve Bank to be saddled with any

greater expense than is necessary. At the same time it may be hoped that the Bank will of its own accord open branches at Karachi, Lahore and several other places as soon as circumstances permit. But the present Bill omits the specific mention of a branch in London which was contained in the Bill of 1928.

The change is explained by the following observations of the Reserve Bank Committee (Report, para. 8) : ' We understand that it is the recognised practice of Central Banks to conduct their operations in another country through the agency of the Central Bank of that country. We do not consider that the Board should be precluded by statute from following this practice Should the Bank arrange to employ the Bank of England as its agent in London, we contemplate that the arrangement would be reciprocal and that the Bank of England would employ the Reserve Bank as its agent in India.'

It must be clearly admitted that there is nothing wrong in the practice of a Central Bank utilising the services of another Central Bank as its agent in a foreign country. But the position of India in relation to England is peculiar in two ways. In the first place, India has such unusually large transactions in England—which are at present partly in the hands of the London branch of the Imperial Bank and partly with the Bank of England¹—that they would fully justify the opening of a London Branch

1. See *Monetary Problems of India*, 1933, p. 113.

of the Indian Reserve Bank. At the same time Indians are suspicious that if the Bank of England is entrusted with agency work, it may be prejudicial to Indian interests. Colour is given to this suspicion by the following unfortunate observations made by the Government of India in its Despatch on Constitutional Reforms, 1930 in which a hope was expressed that 'it would be possible to convince Indian opinion of the desirability that such a bank should work in close co-operation with, *and on lines approved by* the Bank of England.'¹ Indian opinion would welcome co-operation but never agree to subordination. It is the latter and not the former which should be shunned.

On the above two grounds it seems desirable that the Reserve Bank should have a London branch of its own rather than work through an agent. In the latter event, the London branch of the Imperial Bank is already there doing part of the work and there is no particular reason why it should be deprived of the agency work in England when it is proposed that it will do that work in India (see below, p. 77). A London branch of the Reserve Bank would not only give the Bank independence, but also a prestige which it would not otherwise have. Further, even as a strict business proposition, it should prove economical in the long run. London being the financial centre of the world, such a branch would be

1. The italics are mine.

bound to be a useful point of contact with money markets all over the world; and to take a proper share in, and derive full advantage from international business councils. At the same time a London branch would afford a good training centre for suitable Indians and qualify them to fill positions of trust and responsibility.

Structure of the Bank.—On the model of the Bank of England the Bill provides for separate Issue and Banking Departments. But this separation has never been satisfactorily justified and was unreservedly condemned by the Macmillan Committee of 1931. The Committee regarded it ‘as both confusing and misleading to any one who is not an expert’ and thought it ‘inconceivable that any one settling the matter afresh to-day would devise the present form of statutory return’.¹

The only reason advanced by the Reserve Bank Committee is, ‘the provision has met with general approval in India’, but it is doubtful if this is the case since the publication of the report of the Macmillan Committee, and there is no reason why advantage should not be taken in India of that Committee’s authoritative opinion, as done in the New-Zealand Reserve Bank Bill of 1933.

Business.—The Bill of 1933 closely follows the provisions of clauses 17 and 18 of the Bill of 1928 in

1. *Report of the Committee on Finance and Industry*, 1931, London, (Cmd. 3897), paras. 337–340.

regard to the business of the Bank, but a useful provision is made to enable the Bank to act as Bankers for Indian States.

The Reserve Bank Committee has rejected the demand that the Central Bank should be empowered to make loans and advances on the security of movable goods, wares and merchandise, as well as against warehouse warrants and warehouse receipts representing such goods. This is based on the ground that such power would render the Bank's resources less liquid, and might involve it in undesirable competition with commercial banks.

The question was carefully considered by the Indian Banking Committee, and the foreign experts, after discussing the matter from all points of view, had come to the conclusion that in the absence of a fully developed agricultural bill market the Reserve Bank should be given the opportunity of making loans and advances as suggested above if it were to exercise effective control over agricultural credit.¹ They anticipated the objection raised by the Reserve Bank Committee and met it as follows:

'To avoid misunderstanding, it may be added that the Reserve Bank need not necessarily avail itself of this opportunity to a large extent; the mere fact that the opportunity exists will enable the Bank to exercise a strong influence on the level of the rate of interest.'²

1. *Report of the Indian Banking Committee, 1931*, para. 607 ; also pp. 649–652.

2. *Ibid*, p. 652.

It may be added that the proposal is in accord with the central banking policy and practice of many European countries *e.g.*, Germany, France, Greece, Yugoslavia, Latvia, Estonia and that a number of recent modifications in the South African Reserve Bank Act are on the same lines in order to render the working of the Bank more effective.

In regard to open market operations the fact that in recent years they have been playing an increasingly important part in the regulation of credit has been rightly recognised and since action may be necessitated, for the purpose of regulating credit, with a degree of urgency which does not permit prior consultation of the Board, the Board is permitted to delegate powers to the Governor to take necessary action.

3. Relations with Government and the Money Market.

Relations with Government.—Coming to the relations with Government, the Bill of 1933 makes the same provisions as were noted on p. 50 above in connection with the Bill of 1928. But the new Bill takes into account the present *de facto* situation in regard to the linking of the rupee with sterling at 1s. 6d. rate and makes necessary amendments in regard to exchange dealings which are restricted to sterling standard—in place of gold standard—countries. This is a serious drawback but inevitable in the present conditions.

But Indian opinion has never been so strong as now in regard to the revision of the existing rupee-sterling ratio. In the Reserve Bank Committee itself 'a considerable majority of the Indian delegates have felt it their duty to record their view that a suitable exchange ratio is one of the essential factors for the successful working of the Reserve Bank.'

Without going into a detailed analysis, some idea of the gravity of the Indian situation can be had from two broad facts alone *viz.*, (1) enormous shrinkage of India's trade surplus from a decennial average of Rs. 70 crores before the War to Rs. 3 crores in 1932-33 and (2) the export of nearly Rs. 150 crores worth of gold during the last two years (Sept. 1931-Aug. 1933) in place of a normal import of Rs. 40 crores worth of gold during 1926-27 and 1927-28.

Most countries of the world—notably England, America and Japan—have followed their own economic policies suited to their needs and have adopted transitory methods to help their trade without struggling for stabilization of the exchange value of their currencies. This partly explains the recent failure of the World Economic Conference. As Sir George Schuster rightly stated the other day, 'the economic programme which may suit America would not suit France and the gold standard countries; and, therefore, the two parties could not at the present stage agree on a policy which would guarantee the stability of exchange between them'.¹

¹ Extract from Sir George Schuster's statement in an interview to the press, Bombay, August 24, 1933.

Similar feeling has existed in India. For instance the *zamindars* of the Punjab in a recent memorandum to the Governor of the Province expressed their feelings on the Government's monetary policy in the following words:

'Eighteen pence ratio has caused money starvation. Any scheme for improving the agricultural situation should mean the reduction of the exchange ratio to twelve pence a rupee with a view to make up six years' losses caused by the unjust exchange. The extra cost of remittances to England, namely, twenty crores would be insignificant compared to the immense benefits to the country.'

The Vice-President of the Indian Merchants' Chamber at the Second Quarterly General Meeting (29th July, 1933) observed : 'In view of the present disturbed positions of the various currencies of the world, including sterling, and an amount of uncertainty hanging round the question of stabilisation of currencies, the proposal regarding exchange obligations of the Bank requires to be thoroughly examined in relation to its repercussions on not only our internal trade and industries but also in relation to our trade relations with other parts of the world.'

Again, the President of the Bengal National Chamber of Commerce speaking at the Second Quarterly General Meeting (24th August, 1933) said, 'If we admit that the price level is more important than the ratio of exchange, the proposal of the

Reserve Bank Committee to adhere to a fixed ratio (which would almost inevitably be the present ratio) appears to be unsound, because we have found it by experience that its maintenance not infrequently forces us to adopt measures which have serious repercussions upon internal prices. Even if we concede that exchange stability should be achieved and maintained, the ratio at which it should be fixed is a matter on which Indian opinion has differed acutely from the Government. The Rupee to-day is demonstrably over-valued, and the maintenance of its artificial exchange value stands in the way of achieving what is eminently more necessary and desirable—namely, the raising of internal prices. If a higher price-level is considered necessary for economic revival, the artificially high exchange value of the Rupee is the surest device for delaying it.'

The whole question requires an impartial and immediate examination by a small committee. Such an impartial examination will probably reveal that the present policy needs a change.

Relations with Banks.—In the Bill of 1933 the provisions regarding the keeping of the compulsory cash reserves by scheduled or member banks with the Reserve Bank and the criterion for enrolment as a member bank *viz.*, Rs. 3 lakhs paid-up capital and reserve are tentatively the same, but according to the

1. *Memorandum to the Members of the Reserve Bank Committee,*
by S.N. Pochkhanawala, 1933, p. 11.

recommendation of the Reserve Bank Committee, the two questions will receive special consideration in the new Select Committee on the Reserve Bank Bill. This is a matter on which the joint-stock banks must, of course, have their say and the following suggestions of Mr. Pochkhanawala are worthy of consideration.

(1) The scheduled member-banks should deposit in cash with the Reserve Bank 5% of their demand liabilities under call and current accounts deposits, 3% of Savings-Bank Accounts deposits and 1½% of period deposits.

(2) For the first ten years 50% of the above deposits should be in cash and 50% in Gilt-edged securities, so far as indigenous bankers are concerned.

(3) These deposits may be placed by the member banks as may suit them at the Head Office or at any of the branches of the Reserve Bank.

Whatever the final decisions, the larger the number of member banks, the more useful it would be both for the Reserve Rank and in the larger interests of Indian banking.

Relations with the Imperial Bank.—Again as regards the relations between the Reserve Bank and the Imperial Bank of India, the Bill of 1933 reproduces the provisions of its predecessor. While the terms of remuneration are open to revision, the Reserve Bank Committee has definitely recommended that the Imperial Bank should be the sole agent of the Reserve Bank.

Now this is a very serious matter for Indian joint-stock banks. They have already been protesting against the competition of the Imperial Bank, but if, as is proposed, the Imperial Bank is made the sole agent of the Reserve Bank, given the benefit of large funds (Rs. 3 crores) at no interest or nominal interest for a large number of years (25 or 20) and freed from the existing restrictions on its business, it may become a serious menace to Indian joint-stock banking. The representation made to Government by such banks as the Central Bank of India Ltd., the Allahabad Bank Ltd., the Punjab National Bank Ltd., and the Indian Bank Ltd., on the 7th March, 1927 still holds good and deserves serious consideration. In the course of a letter addressed to the Deputy Secretary to the Government of Bombay they observed :

'With Government support and Government money the Imperial Bank has been competing with the business of the indigenous banks at uneconomic rates. The proposed advantages to the Imperial Bank under the new Act will make the development of branch banking exceedingly difficult, if not impossible, for indigenous banks. Under the proposed Act the Imperial Bank will receive preferential treatment and large benefits whereas indigenous banks which have done much more than the Imperial Bank in the development of branch banking will suffer heavily.'

It must be recognised that there was some justification for giving preferential treatment to the Imperial Bank in 1927, as Government had then an agreement with that bank for a period of which four years were still unexpired. But that agreement expired in 1931. The present agreement is on yearly basis, and the Imperial Bank has had full knowledge of the proposal for a Reserve Bank for the last six years, if not more. In the circumstances, the way is clear for treating all banks alike and letting the member banks share the prestige and remuneration of the Reserve Bank's agency work among themselves on a fair and equitable basis. This should not only prove more economical, but also lead to a healthy development of indigenous banking which it is the duty of the Reserve Bank to foster and not hamper. The suggestion receives added force from the fact that under the new scheme member banks would have to keep certain compulsory "interest-free" deposits with the Reserve Bank and in their present weak position as compared to the Imperial Bank or foreign banks, it is they, and not the Imperial Bank, which deserve to be specially encouraged.

No Relations with Indigenous Bankers.—In the treatment of the Reserve Bank's relations with banks, it is significant that the Bill under examination ignores the indigenous bankers altogether. As was pointed out in the last chapter, this is a serious matter, because modern banks touch only

the upper surface of India's economic life, the lower strata or the vital parts being really served by the indigenous bankers. In order that the Reserve Bank may have a real scope of usefulness, it is essential that the indigenous bankers should be brought into direct relation with the Reserve Bank. This would have the effect of linking up the indigenous bankers with the general money market and their status would be improved and raised therein. It must be recognised, however, that before this can be done, indigenous bankers must agree to (a) confine themselves to banking business only, (b) satisfy a standard regarding their capital and reserve such as may be framed by the Reserve Bank, (c) maintain proper books of accounts subject to regular audit and inspection by the Reserve Bank, (d) keep compulsory deposits with the Bank (but for the first five years of the Bank's working, bankers whose deposits do not exceed five times their capital may be exempted from this condition), and (e) charge the public such rates as are not 'unduly high'.

As against the foregoing obligations the indigenous bankers may be given the following privileges—*viz.*, (a) be eligible to be placed on the approved list of the Reserve Bank in the same manner as the joint-stock banks and have their bills discounted by the Reserve Bank (b) receive facilities for remittance of funds through the Imperial Bank or the Reserve Bank on the same terms as the joint-stock banks, and

(c) get the benefit of the Bankers' Books Evidence Act.¹

4. Miscellaneous.

The miscellaneous provisions in the new Bill relate to the same matters as in the old Bill (p. 53 above) and are almost identical.

The maximum dividend permissible to the shareholders has been reduced from 7 per cent. as in the Bill of 1928 to 6 per cent.

Experts' Committee.—The examination of the new Bill has now come to a close, and a few additional suggestions may be appropriately made. In the first place, the Directors of the Bank retiring by rotation might form a separate Committee so that their advice would still be available to the Bank.²

Economic Advisers.—The Bank should also be provided with the technical assistance of one or two eminent economists as Economic Advisers. Such a provision is not uncommon in other countries and should prove of special advantage in India where scientific studies of Indian economic conditions are not readily available and statistics are in a stage of absolute infancy.

Banking Statistics.—A word may be said in regard to Indian banking statistics specially, which

1. *Indian Banking Committee Report*, paras 139–142. Cf. my almost identical suggestions to the *United Provinces Banking Enquiry Committee*, 1929-30, *Evidence*, vol. ii., pp. 129-30.

2. *The Theory and History of Banking* by C. F. Dunbar, 1929, p. 167.

are admittedly poor. Indian joint-stock banks might well emulate in this respect the example of British joint-stock banks which publish much useful information in their monthly reviews. But in the matter of financial statistics America leads the way. Following the model of the Federal Reserve Bulletin,¹ it should be one of the duties of the Reserve Bank to collect and co-ordinate data from all the member banks and publish them speedily and in convenient form, at regular intervals, for the information and education of the general public. For this purpose the Bank should have an office for collecting and preparing statistics regarding industry and commerce, showing trends of trade both at home and in foreign countries.

The importance of such statistics can hardly be exaggerated. 'For the complete information,' in the words of the Macmillan Committee (Report, para. 425) 'which would thus be put at the disposal of those responsible for deciding policy, may prove to be an indispensable preliminary to their being able to work out practical methods of management for attaining the objectives of the monetary system. To put on a more scientific basis our acquaintance with the fundamental facts and trends of our economic life, and to replace empiricism by ordered knowledge, might prove to be the greatest step forward that it lies

1. *The Reserve Banks and the Money Market*, by W. R. Burgess, 1927, pp. 6-7.

within our power to take towards raising the economic well-being of our country to the level which the technique of production would allow, provided only that our machinery for collective action was such as to facilitate the whole of our productive resources being brought into fruitful activity. Following the recommendations of the Macmillan Committee the Bank of England now publishes a monthly Statistical Summary which is much appreciated.

It may be pointed out that the Government of India is not oblivious of the need of proper statistical material. In April 1933, the Standing Finance Committee observed, '...it is also most essential, in view of the forthcoming creation of a Reserve Bank that there should be in existence an organization for the collection and correlation of the data essential for a proper appreciation of the current economic situation on which the course to be followed by the Bank in the exercise of its functions of currency control must largely depend'.¹ Since then Government has set up a Statistical Research Branch of the Department of Commercial Intelligence and Statistics with the above as one of its objects, and any effort, however modest, to improve official statistics must be welcomed. But it would be best for the Reserve Bank to have from the outset its own independent organisation, which would probably give quicker results and certainly inspire greater confidence.

1. *Proceedings of the meeting of the Standing Finance Committee, 12th April, 1933, para 1.*

Conclusion.—In conclusion it may be emphasised that the suggestions in this chapter are interdependent and must be taken as a whole. If any one of them is not accepted, others may need consequential modification. For example, one of the basic assumptions for the establishment of the Reserve Bank unanimously made by the Indian Banking Committee was that the control of the Reserve Bank must be Indian. This is best provided, as in other countries, by restricting the holding of shares to nationals, otherwise it must be provided in the directorate itself. The one supreme test of the Reserve Bank constitution must be whether in the words of Sir Basil Blackett, ‘control of Indian currency and finance will be transferred from a centre situated at some point between White Hall and Delhi into sole control of India.’¹ It is on this test and this test alone that the satisfaction of Indian opinion and the success of the Reserve Bank will largely depend.

I Quoted above p. 25.

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APPENDIX

A

BILL

TO

Constitute a Reserve Bank of India.

WHEREAS it is expedient to constitute a Reserve Bank for India to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in British India, and generally to make provisions for matters incidental thereto;

AND WHEREAS in the present disorganisation of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system;

BUT WHEREAS it is expedient to make temporary provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary position has become sufficiently clear and stable to make it possible to frame permanent measures;

It is hereby enacted as follows:—

CHAPTER I.

PRELIMINARY.

1. (1) This Act may be called the Reserve Bank
Short title, extent, of India Act, 1933.
commencement and
duration.

(2) It extends to the whole of British India, including British Baluchistan and the Sonthal Parganas.

(3) This section shall come into force at once, and the remaining provisions of this Act shall come into force on such date or dates as the Governor General in Council may, by notification in the Gazette of India, appoint.

(4) Chapter III shall remain in force for a period of twenty-five years and thereafter until repealed.

2. In this Act, unless there is anything repugnant Definitions. in the subject or context,—

- (a) "the Bank" means the Reserve Bank of India constituted by this Act;
- (b) "bank note" means paper money issued by the Bank;
- (c) "the Central Board" means the Central Board of Directors of the Bank;
- (d) "sterling standard country" means the United Kingdom and any country, other than British India, in which any person is entitled by law to obtain sterling on demand from the principal currency authority of that country, on payment at a fixed rate in the legal tender currency of that country;
- (e) "provincial co-operative bank" means any society which is registered or deemed to be registered under the Co-operative Societies Act, 1912, or any other law for the time being in force in British India relating to co-operative societies and the sole business and object of which is the financing of the other societies in a province which are or are deemed to be so registered;

- (f) "rupee coin" means silver rupees which are legal tender under the provisions of the Indian Coinage Act, 1906; and
- (g) "scheduled bank" means a bank included in the Second Schedule.

CHAPTER II.

INCORPORATION, SHARE CAPITAL, MANAGEMENT AND BUSINESS.

3. (1) A Bank to be called the Reserve Bank of India shall be constituted for the purposes of taking over the management of the currency from the Governor General in Council and of carrying on the business of banking in accordance with the provisions of this Act.

(2) The Banks shall be a body corporate by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued.

4. (1) The original share capital of the Bank Share capital, share shall be five crores of rupees divided registers and share- into shares of five hundred rupees holders. each, which shall be fully paid up.

(2) Separate registers of shareholders shall be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon, and separate issue of shares shall be made in each of the areas served by those registers, as defined in the First Schedule, and shares shall be transferable from one register to another.

(3) A shareholder shall be qualified to be registered as such in any area in which he is ordinarily resident

or has his principal place of business in India, but no person shall be registered as a shareholder in more than one register; and no person who is not—

- ((a) domiciled in India, or
- (b) a British subject ordinarily resident in India, or
- (c) a company registered under the Indian Companies Act, 1913, or a society registered under the Co-operative Societies Act, 1912, or a scheduled bank, or a corporation or company incorporated by or under an Act of Parliament or any law for the time being in force in any of His Majesty's dominions and having a branch in British India,

shall be registered as a shareholder or be entitled to payment of any dividend on any share.

(4) The Central Board may, at its discretion, without giving any reason, decline to allot shares to any applicant or to register any transfer of shares.

(5) The nominal value of the shares originally assigned to the various registers shall be as follows, namely:—

- (a) to the Bombay register—one hundred and sixty-five lakhs of rupees;
- (b) to the Calcutta register—one hundred and sixty-five lakhs of rupees;
- (c) to the Delhi register—eighty lakhs of rupees;
- (d) to the Madras register—fifty lakhs of rupees;
- (e) to the Rangoon register—forty lakhs of rupees:

Provided that, in the event of the shares assigned to any register not being fully taken up at the first

allotment, the Central Board may, with the previous sanction of the Governor General in Council, transfer a portion of such shares from that register to another.

(6) In allotting the shares assigned to a register, the Central Board shall, in the first instance, allot two shares to each qualified applicant who has applied for two or more shares; and, if the number of such applicants is greater than half the total number of shares assigned to the register, shall determine by lot the applicants to whom the shares shall be allotted.

If the number of such applicants is less than half the number of shares assigned to the register, the Central Board shall allot the remaining shares to applicants who have applied for more shares than two; and if the number of extra shares so applied for exceeds the number of shares to be allotted, the Central Board shall allot them among the various applicants in such manner as it may deem fair and equitable, having regard to the desirability of distributing the shares and the voting rights attached to them as widely as possible.

If any shares still remain unallotted, the Central Board shall allot them to applicants who have applied for one share only; and if the number of shares so applied for exceeds the number of shares to be so allotted, the Central Board shall determine by lot the applicants to whom the shares shall be allotted.

If, after all applications have been met in accordance with the provision of this sub-section, any share remain unallotted, they shall, notwithstanding anything contained in this section, be allotted to and taken up by Government, and shall be sold by the Governor General in Council, at not less than par, as soon as may be.

The Governor General in Council shall have no right to exercise any vote under this Act by reason of any

shares so allotted to him.

5. : (1) The share capital of the Bank may be increased by the Central Board with the previous sanction of the Governor General in Council.

Increase and reduction of share capital.

(2) Every such increase shall be fully paid up, and the areas to which such further shares shall be allotted and the price at which they may be issued shall be fixed by the Central Board with the like sanction.

(3) The Central Board may determine the manner in which any increase of share capital shall be effected

(4) The share capital of the Bank may be reduced by the Central Board, with the previous sanction of the Governor General in Council, to such extent and in such manner as may be determined by the Bank in general meeting.

6. The Head Office of the Bank shall be established in Bombay, and the Bank shall, as soon as may be, establish branches in Calcutta, Delhi, Madras and Rangoon, and may establish branches or agencies in any other place in India or, with the previous sanction of the Governor General in Council, elsewhere.

Head Office, branches and agencies.

7. The general superintendence of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank and are not by this Act expressly directed or required to be done by the Bank in general meeting.

8. (1) The Central Board shall consist of the following Directors, namely:—

Composition of the Central Board, and term of office of Directors.

- (a) a Governor and one Deputy Governor or two Deputy Governors, to be appointed by the Governor General in Council after consideration of the recommendations made by the Board in that behalf;
- (b) four Directors to be nominated by the Governor General in Council;
- (c) eight Directors to be elected on behalf of the shareholders on the various registers, in the manner provided in section 9 and in the following numbers, namely:—
 - (i) for the Bombay register—two Directors;
 - (ii) for the Calcutta register—two Directors;
 - (iii) for the Delhi register—two Directors;
 - (iv) for the Madras register—one Director;
 - (v) for the Rangoon register—one Director; and
- (d) one government official to be nominated by the Governor General in Council.

(2) The Governor and Deputy Governors shall devote their whole time to the affairs of the Bank, and shall receive such salaries and allowances as may be determined by the Central Board, subject to any minimum prescribed by the Governor General in Council.

(3) A Deputy Governor and the Director nominated under clause (d) of sub-section (1) may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote:

Provided that when the Governor is absent a Deputy

Governor authorised by him in this behalf in writing may vote for him.

(4) The Governor and Deputy Governor shall hold the office for such term not exceeding five years as the Governor General in Council may fix when appointing them, and shall be eligible for re-appointment.

A Director elected under clause (c) of sub-section (1) shall hold office for five years, or thereafter until his successor shall have been duly elected, and, subject to the provisions of section 10, shall be eligible for re-election.

The Directors nominated under clause (b) and clause (d) of sub-section (1) shall hold office during the pleasure of the Governor General in Council.

(5) No act or proceeding of the Board shall be questioned on the ground merely of the existence of any defect in the constitution of the Board.

9. (1) A Local Board shall be constituted for each Local Boards, their of the five areas specified in the First constitution and Schedule, and shall consist of—

- (a) five members elected from amongst themselves by the shareholders who are registered on the Register for that area and are qualified to vote, and
- (b) not more than three members nominated by the Central Board, who may be nominated at any time.

(2) At an election of members of a Local Board for any area, any shareholder who has been registered on the Register for that area, for a period of not less than six months ending with the date of the meeting, as holding two shares shall have one vote, and each shareholder so registered as having more than two shares shall

have one vote for each two shares, but subject to a maximum of ten votes.

(3) The members of a Local Board shall hold office until they vacate it under sub-section (5) and, subject to the provisions of section 10, shall be eligible for re-election or re-nomination, as the case may be.

(4) At any time within three months of the day on which the Directors representing the shareholders on any register are due to retire under the provisions of this Act, the Central Board shall direct an election to be held of members of the Local Board concerned, and such election shall be held forthwith and the names of the persons elected shall be notified to the Central Board.

(5) On such notification, the Central Board shall proceed to make any nominations permitted by clause (b) of sub-section (1) it may then decide to make, and shall fix the date on which the outgoing members of the Local Board shall vacate office, and the incoming members shall be deemed to have assumed office on that date.

(6) The elected members of a Local Board shall, as soon as may be after they have been elected, elect from amongst themselves one or two persons, as the case may be, to be Directors representing the shareholders on the register for the area for which the Board is constituted.

(7) A Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it and shall perform such duties as the Board may, by regulations, delegate to it.

10. (1) No person may be a Director or a member of a Local Board who is not or has disqualifications of not at some time been—
Directors and members of Local Boards.

- (a) engaged in the direction of agricultural, commercial, financial or industrial activities, or
- (b) a director of any company as defined in clause (2) of section 2 of the Indian Companies Act, 1913, or of a corporation or company incorporated by or under any law for the time being in force in any place outside British India.

(2) No person may be a Director or a member of a Local Board who—

- ((a) is a government official or an official of a State in India, or
- (b) is, or at any time has been, adjudicated an insolvent, or
- (c) is an officer or employee of any bank, or
- (d) is a director of any bank, other than a registered society as defined in clause (e) of section 2 of the Co-operative Societies Act, 1912:

Provided that an official of a State in India (not being a government official on deputation in the State) may be nominated as a Director or as a member of a Local Board.

(3) Nothing in this section shall apply to the Governor or to the Director nominated under clause (d) of sub-section (1) of section 8.

11. (1) The Governor General in Council may remove from office the Governor, or a Removal from and Deputy Governor or any nominated vacation of office. or elected Director:

Provided that in the case of an elected Director this power shall be exercised only on a resolution passed by the Central Board in that behalf by a majority consisting of not less than nine Directors.

(2) A Director nominated or elected under clause (b) or clause (c) of section 8, and any member of a Local Board shall cease to hold office if, at any time after six months from the date of his nomination or election, or eighteen months from the commencement of this Act, whichever is later, he is not registered as a holder of unencumbered shares of the Bank of a nominal value of not less than ten thousand rupees, or if he ceases to hold unencumbered shares of that value.

(3) The Governor General in Council may remove from office any Director, and the Central Board may remove from office any member of a Local Board, if such Director or member becomes subject to any of the disqualifications specified in sub-section (2) of section 10.

(4) The appointment, nomination or election as Director or member of a Local Board of any person who is a member of the Indian Legislature or of a Local Legislature shall be void, unless, within one month of the date of his appointment, nomination or election, he ceases to be such member, and, if any Director or member of a Local Board is elected or nominated as a member of any such Legislature, he shall cease to be a Director or member of the Local Board as from the date of such election or nomination, as the case may be.

(5) A Director may resign his office to the Governor General in Council, and a member of a Local Board may resign his office to the Central Board, and on the acceptance of the resignation the office shall become vacant.

12. (1) If the Governor or a Deputy Governor by infirmity or otherwise is rendered incapable of executing his duties or is absent on leave or otherwise in circumstances not involving the vacation of his appointment, the Governor General in Council may appoint another person to officiate for him, and such person may, notwithstanding anything contained in clause (c) of sub-section (2) of section 10, be an officer of the Bank.

(2) If an elected Director is for any reason unable to attend a particular meeting of the Central Board, the elected members of the Local Board of the area which he represents may elect one of their number to take his place, and for the purposes of that meeting the substitute so elected shall have all the powers of the absent Director.

(3) A casual vacancy in the office of a Director, other than the vacancies provided for in sub-section (1), shall be filled in the manner in which, and by the authority by whom, the nomination or election of the Director vacating office was made; and the Director so nominated or elected shall hold office for the unexpired portion of the term of his predecessor.

(4) Where any casual vacancy in the office of any member of a Local Board occurs, the Central Board may nominate thereto any qualified person recommended by the Local Board, and the person so nominated shall hold

office for the unexpired period of the term of his predecessor.

13. (1) Meetings of the Central Board shall be convened by the Governor at least six times in each year and at least once in each quarter. Meetings shall ordinarily be held in Bombay, but at least two meetings of the Central Board shall be held in Calcutta in each year.

(2) The Governor, or in his absence the Deputy Governor authorised by the Governor under the proviso to sub-section (3) of section 8 to vote for him, shall preside at meetings of the Central Board, and, in the event of an equality of votes, shall have a second or casting vote.

14. (1) A general meeting (hereinafter in this Act referred to as the annual general meeting) shall be held annually at Bombay within six weeks from the date on which the annual accounts of the Bank are closed, and a general meeting may be convened by the Central Board at any other time.

(2) Any shareholder shall be entitled to attend any general meeting, and each shareholder who has been registered on any Register, for a period not less than six months ending with the date of the meeting, as holding two shares shall have one vote, and each shareholder so registered as having more than two shares shall have one vote for each two shares, but subject to a maximum of ten votes; and such votes may be exercised by proxy.

15. (1) The following provisions shall apply to the first constitution of the Central Board, and, notwithstanding anything contained in section 8, the Central Board

First constitution
of the Central
Board.

as constituted in accordance therewith shall be deemed to be constituted in accordance with this Act.

(2) The first Governor and the first Deputy Governor or Deputy Governors shall be appointed by the Governor General in Council on his own initiative, and shall receive such salaries and allowances as he may determine.

(3) The first eight Directors representing the shareholders on the various Registers shall be nominated by the Governor General in Council after consultation with the Local Governments concerned.

(4) A Director so nominated to represent shareholders on the Bombay or Calcutta Register shall hold office for two years, and a Director so nominated to represent shareholders on the Delhi, Madras or Rangoon Register shall hold office for four years, or thereafter until his successor shall have been duly elected.

16. As soon as may be after the commencement of this Act, the Central Board shall direct elections to be held and may make nominations, in order to constitute Local Boards in accordance with the provisions of section 9, and the members of such Local Boards shall hold office up to the date fixed under sub-section (5) of section 9 but shall not exercise any right under sub-section (6) of that section.

17. The Bank shall be authorised to carry on and transact the several kinds of business which the Bank may transact hereinafter specified, namely:—

(1) the accepting of money on deposit without interest from, and the collection of money for, the Secretary of State in Council, the Governor General in Council, Local Govern-

ments, States in India, banks and any other persons;

- (2) (a) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India and arising out of *bona fide* commercial or trade transactions, bearing two or more good signatures, one of which shall be that of a scheduled bank, and maturing within ninety days from the date of such purchase or rediscount, exclusive of the days of grace;
- (b) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India and bearing two or more good signatures, one of which shall be that of a scheduled bank, or a provincial co-operative bank, and drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops, and maturing within six months from the date of such purchase or rediscount, exclusive of days of grace: provided that the total face value of bills or notes so purchased or rediscounted shall not at any time exceed one-fourth of the total face value of all bills and notes purchased or rediscounted by the Bank up to that time;
- (c) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India and bearing

the signature of a 'scheduled bank, and issued or drawn for the purpose of holding or trading in securities of the Government of India or a Local Government, or such securities of States in India as may be specified in this behalf by the Governor General in Council on the recommendation of the Central Board, and maturing within ninety days from the date of such purchase or rediscount, exclusive of days of grace;

- (3) the purchase from and sale to scheduled banks and persons approved by the Central Board, in amounts of not less than the equivalent of one lakh of rupees, of the currencies of such sterling standard countries as may be specified in this behalf by the Governor General in Council by notification in the Gazette of India, and of bills of exchange (including treasury bills) drawn in or on any place in any such country, and maturing within ninety days from the date of such purchase, exclusive of days of grace; and the keeping of balances with banks in such countries;
- (4) the making of loans and advances, repayable on demand or on the expiry of fixed periods not exceeding ninety days, against the security of—
 - (a) stocks, funds and securities (other than immovable property) in which a trustee

is authorised to invest trust money by any Act of Parliament or by any law for the time being in force in British India;

- (b) gold coin or bullion or documents of title to the same;
- (c) such bills of exchange and promissory notes as are eligible for purchase or rediscount by the bank: provided that the total of the loans and advances against such securities as are referred to in sub-clause (b) of clause (2) shall not at any time exceed one-fourth of the total loans and advances made by the Bank up to that time;
- (d) such bills of exchange as are eligible for purchase by the Bank under clause (3);
- (e) promissory notes of any scheduled bank or a provincial co-operative bank, supported by documents evidencing title to goods which have been transferred, assigned, hypothecated or pledged to any such bank as security for a cash credit granted for *bona fide* commercial or trade transactions, or for the purpose of financing seasonal agricultural operations or the marketing of crops: provided that no loan or advance shall be made on the security of any promissory note such as is referred to in this sub-clause after the expiry of five years from the date on which this section

comes into force;

- (5) the making of advances to the Governor General in Council repayable in each case not later than three months after the close of the financial year in respect of which the advance has been made;
- (6) the issue of demand drafts and the making, issue and circulation of bank post bills made payable on its own branches;
- (7) the purchase and sale of securities, maturing within five years from the date of such purchase, of the Government of any sterling standard country specified in this behalf by the Governor General in Council by notification in the Gazette of India;
- (8) the purchase and sale of securities of the Government of India of any maturity, or of a Local Government or of a local authority in British India maturing within ten years from the date of purchase, or of such securities of States in India of like maturity as may be specified in this behalf by the Governor General in Council on the recommendation of the Central Board: provided that the amount of such securities held at any time in the Banking Department shall be so regulated that—
 - (a) the total value of such securities shall not exceed the aggregate amount of the share capital of the Bank, the Reserve Fund and two-fifths of the liabilities of the Banking Department in respect of deposits;

- (b) the value of such securities maturing after six months shall not exceed the aggregate amount of the share capital of the Bank, the Reserve Fund and one-fifth of the liabilities of the Banking Department in respect of deposits;
- (c) the value of such securities maturing after one year shall not exceed the aggregate amount of the share capital of the Bank, the Reserve Fund and one-tenth of the liabilities of the Banking Department in respect of deposits; and
- (d) the value of such securities maturing after ten years shall not exceed the aggregate amount of the share capital of the Bank and the Reserve Fund;
- (9) the custody of monies, securities and other articles of value, and the collection of the proceeds, whether principal, interest or dividends, of any such securities;
- (10) the sale and realisation of all property, whether movable or immovable, which may in any way come into the possession of the Bank in satisfaction, or part satisfaction, of any of its claims;
- (11) the acting as agent for the Secretary of State in Council, the Governor General in Council or any Local Government or State in India in the transaction of any of the following kinds of business, namely:—
 - (a) the purchase and sale of gold or silver;
 - (b) the purchase, sale, transfer and custody

of bills of exchange, securities or shares in any company;

- (c) the collection of the proceeds, whether principal, interest or dividends, of any securities or shares;
- (d) the remittance of such proceeds, at the risk of the principal, by bills of exchange payable either in India or elsewhere;
- (e) the management of public debt;
- (12) the purchase and sale of gold coin and bullion;
- (13) the opening of an account with, and the acting as agent or correspondent of, any other bank which is the principal currency authority of a sterling standard country under the law for the time being in force in that country;
- (14) the borrowing of money for a period not exceeding one month for the purposes of the business of the Bank, and the giving of security for money so borrowed:

Provided that no money shall be borrowed under this clause from any person in India other than a scheduled bank, or from any person outside India other than a bank which is the principal currency authority of any country under the law for the time being in force in that country:

Provided further that the total amount of such borrowings from persons in India shall not at any time exceed the amount of the share capital of the Bank;

- (15) the making and issue of bank notes subject to the provisions of this Act; and
- (16) generally, the doing of all such matters and things as may be incidental to or consequential upon the exercise of its power or the discharge of its duties under this Act.

18 When, in the opinion of the Central Board,
 Power of direct or, where the powers and functions of
 discount. the Central Board under this section
 have been delegated to the Governor,
 in the opinion of the Governor, it is necessary or expedient that action should be taken under this section for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture, the Bank may, notwithstanding any limitation contained in sub-clauses (a) and (b) of clause (2) of section 17, purchase, sell or discount any bills of exchange or promissory notes drawn and payable in India and arising out of *bona fide* commercial or trade transactions, bearing two or more good signatures and maturing within ninety days from the date of such purchase or discount, exclusive of days of grace.

19. Save as otherwise provided in sections 17, 18
 Business which the and 43, the Bank may not—
 Bank may not
 transact.

- (1) engage in trade or otherwise have a direct interest in any commercial, industrial, or other undertaking, except such interest as it may in any way acquire in the course of the satisfaction of any of its claims: provided that all such interests shall be disposed of at the earliest possible moment;

- (2) purchase its own shares or the shares of any other bank or of any company, or grant loans upon the security of any such shares;
- (3) advance money on mortgage of, or otherwise on the security of, immovable property or documents of the title relating thereto, or become the owner of immovable property, except so far as is necessary for its own business premises and residences for its officers and servants;
- (4) make unsecured loans or advances;
- (5) draw or accept bills payable otherwise than on demand;
- (6) allow interest on deposits or current accounts.

CHAPTER III.

CENTRAL BANKING FUNCTIONS.

20. The Bank shall undertake to accept monies for

Obligation of the account of the Secretary of State in
 Bank to transact Council and the Governor General
 Government busi- in Council and such Local Govern-
 ness. ments as may have the custody and
 management of their own provincial revenues, and to
 make payments up to the amount standing to the credit
 of their accounts respectively, and to carry out their
 exchange, remittance and other banking operations, in-
 cluding the management of the public debt, on such
 conditions as may be agreed upon.

21. (1) The Governor General in Council and such Local Governments as may have Bank to have the right to transact Government business in India. the custody and management of their own provincial revenues shall undertake to entrust the Bank, on such conditions as may be agreed upon, with all their money, remittance, exchange and banking transactions in India and in particular, to deposit free of interest all their cash balances with the Bank:

Provided that nothing in this sub-section shall prevent the Governor General in Council or any Local Government from carrying on money transactions at Government treasuries or sub-treasuries at places where the Bank has no branches or agencies, and the Governor General in Council and Local Governments may hold at such treasuries and sub-treasuries such balances as they may require.

(2) The Governor General in Council and each Local Government shall undertake to entrust the Bank, on such conditions as may be agreed upon, with the management of the public debt and with the issue of any new loans in India.

22. (1) The bank shall have the sole right to issue paper money in British India, and Right to issue bank notes. may, for a period of one year from the date on which this Chapter comes into force, issue currency notes of the Government of India supplied to it by the Governor General in Council, and the provisions of this Act applicable to bank notes shall, unless a contrary intention appears, apply to all currency notes of the Government of India issued either by the Governor General in Council or by the Bank in like manner as if such currency notes were bank notes,

and references in this Act to bank notes shall be construed accordingly.

(2) On and from the aforesaid date the Governor General in Council shall not issue any currency notes or any other kind of paper money.

23. (1) The issue of bank notes shall be conducted by the Bank in an Issue Department which shall be separated and kept wholly distinct from the Banking Department, and the assets of the Issue Department shall not be subject to any liability other than the liabilities of the Issue Department as hereinafter defined in section 34.

(2) The Issue Department shall not issue bank notes to the Banking Department or to any other person except in exchange for other bank notes or for such coin, bullion or securities as are permitted by this Act to form part of the Reserve.

24. Bank notes shall be of the denominational values Denominations of five rupees, ten rupees, fifty rupees, notes. one hundred rupees, five hundred rupees, one thousand rupees, and ten thousand rupees, and of such other denominational values, if any, as may be directed by the Governor General in Council.

25. The design, form and material of bank notes Form of bank notes shall be such as may be approved by the Governor General in Council.

26. (1) Subject to the provisions of sub-section (2), every bank note shall be legal tender at any place in British India in payment or on account for the amount expressed therein, and shall be guaranteed by the Governor General in Council.

(2) The Governor General in Council may, by

Legal tender character of notes.

notification in the Gazette of India, declare that, with effect from such date as may be specified in the notification, any series of bank notes of any denomination shall cease to be legal tender save at any office or agency of the Bank.

27. Any bank note re-issued from any office of the Bank shall be sterilized and disinfected before re-issue, and the Bank shall not re-issue bank notes which are torn, defaced or excessively soiled.

28. Notwithstanding anything contained in any enactment or rule of law to the contrary, no person shall of right be entitled to recover from the Governor General in Council or the Bank the value of any lost, stolen, mutilated or imperfect currency note of the Government of India or bank note:

Provided that the Bank may, with the previous sanction of the Governor General in Council, prescribe the circumstances in and the conditions and limitations subject to which the value of such currency notes or bank notes may be refunded as of grace.

29. The Bank shall not be liable to the payment of any stamp duty under the Indian Stamp Act, 1899, in respect of bank notes issued by it.

30. If at any time the Bank fails to comply with any provision of this Chapter or with any other provision of this Act., the Governor General in Council may, by notification in the Gazette of India, declare that the Bank has forfeited the right of note issue, and shall there-

Powers of Government in respect of note issue and assets of the Bank in certain circumstances

upon take over the liabilities of the Issue Department, together with such portion of the assets of the Bank as is required to meet such liabilities, and thereafter the business of the Issue Department shall be carried on in the manner prescribed by this Act by such agency as the Governor General in Council may determine.

31. No person in British India other than the Bank or, as expressly authorised by Issue of demand bills and notes. this Act, the Governor General in Council shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand of any such person:

Provided that cheques or drafts payable to bearer on demand or otherwise may be drawn on a person's account with a banker, shroff or agent.

32. (1) Any person contravening the provisions of section 31 shall, on conviction by a Penalty. Presidency Magistrate or a Magistrate of the first class, be punishable with fine equal to the amount of the bill, hundi, note or engagement in respect whereof the offence is committed.

(2) No prosecution under this section shall be instituted except on complaint made by the Bank.

33. (1) The assets of the Issue Department shall consist of gold coin, gold bullion, securities of sterling standard countries, rupee coin and rupee securities to such aggregate amount as is not less than the total of the liabilities of the Department as hereinafter defined.
Assets of the Issue Department.

(2) Of the total amount of the assets, not less than two-fifths shall consist of gold coin, gold bullion or securities of 'sterling standard countries':

Provided that the amount of gold coin and gold bullion shall not at any time be less than thirty-five crores of rupees in value.

(3) The remainder of the assets shall be held in rupee coin, Government of India rupee securities of any maturity and such bills of exchange and promissory notes drawn and payable in British India as are eligible for purchase by the Bank under sub-clause (a) or sub-clause (b) of clause (2) of section 17 or under section 18:

Provided that the amount held in Government of India rupees securities shall not at any time exceed one-fourth of the total amount of the assets or fifty crores of rupees, whichever amount is less.

(4) For the purposes of this section, gold coin and bullion shall be valued at 8.47512 grains of fine gold per rupee, rupee coin shall be valued at its face value, and securities shall be valued at the market rate for the time being obtaining.

(5) Of the gold coin and gold bullion held as assets, not less than seventeen-twentieths shall be held in British India, and all gold coin and gold bullion held as assets shall be held in the custody of the Bank or its agencies:

Provided that gold belonging to the Bank which is in any other bank or in any mint or treasury or in transit may be reckoned as part of the assets.

(6) For the purposes of this section, the securities of a 'sterling standard country' which may be held as part of the assets shall be securities of any of the following kinds payable in the currency of any of such ster-

ding standard countries as may be specified in this behalf by the Governor General in Council by notification in the Gazette of India namely:—

- (a) balances at the credit of the Issue Department with a bank which is the principal currency authority under the law for the time being in force of such country;
- (b) bills of exchange bearing two or more good signatures and drawn on and payable at a place in any such country and having a maturity not exceeding ninety days;
- (c) securities maturing within five years of the Government of any sterling standard country specified in this behalf by the Governor General in Council by notification in the Gazette of India:

Provided that, for a period of two years from the date on which this Chapter comes into force,—

- (i) any of such last mentioned securities may be securities maturing after five years, and the Bank may, at any time before the expiry of that period, dispose of such securities notwithstanding anything contained in section 17, and
- (ii) sterling securities of the Government of India may be held as part of the assets.

34. (1) The liabilities of the Issue Department

*Liabilities of the
Issue Department.*

shall be an amount equal to the total of the amount of the currency notes of the Government of India and bank notes for the time being in circulation.

(2) For the purposes of this section, any currency notes of the Government of India or bank note which has not been presented for payment within forty years from the 1st day of April following the date of its issue shall be deemed not to be in circulation, and the value thereof shall, notwithstanding anything contained in sub-section (2) of section 23, be paid by the Issue Department to the Governor General in Council or the Banking Department, as the case may be; but any such note, if subsequently presented for payment, shall be paid by the Banking Department, and any such payment in the case of a currency note of the Government of India shall be debited to the Governor General in Council.

35. On the date on which this Chapter comes into force, the Issue Department shall take initial assets and over from the Governor General in liabilities. Council the liability for all the currency notes of the Government of India for the time being in circulation, and the Governor General in Council shall transfer to the Issue Department gold coin, gold bullion, securities to such aggregate amount as is equal to the total of the amount of the liability so transferred. The coin, bullion and securities shall be transferred in such proportion as to comply with the requirements of section 33:

Provided that the total amount of the gold coin, gold bullion and securities of sterling standard countries so transferred shall not be less than one half of the whole amount transferred, and that the amount of rupee coin, so transferred shall not exceed fifty crores of rupees.

36. (1) After the close of any financial year in which the minimum amount of rupee coin held in the assets, as shown in any of the weekly accounts of the

Method of dealing with fluctuations in rupee coin assets.

Issue Department for that year prescribed under sub-section (1) of section 49, is greater than fifty crores of rupees or one-tenth of the total amount of the assets as shown in that account, whichever may be the greater, the Bank may deliver to the Governor General in Council rupee coin up to the amount of such excess but not without his consent exceeding five crores of rupees, against payment of legal tender value in the form of bank notes, gold or securities:

Provided that if the Bank so desires and if the amount of gold coin, gold bullion and securities of a sterling standard country in the assets does not at that time exceed one-half of the total assets, a proportion not exceeding two-fifths of such payment shall be in gold coin, gold bullion or such securities of a sterling standard country as may be held as part of the assets under sub-section (6) of section 33.

(2) After the close of any financial year in which the maximum amount of rupee coin held in the assets, as so shown, is less than fifty crores of rupees or one-tenth of the total amount of the assets, as so shown, whichever may be the greater, the Governor General in Council may deliver to the Bank rupee coin up to the amount of such deficiency, but not without his consent exceeding five crores of rupees, against payment of legal tender value.

37. (1) Notwithstanding anything contained in the foregoing provisions, the Bank may, with the previous sanction of the Governor General in Council, for

Suspension of assets requirements.

periods not exceeding thirty days in the first instance, which may, with the like sanction, be extended from time to time by periods not exceeding fifteen days, hold as assets gold coin, gold bullion or securities of a sterling standard country of less aggregate amount than that required by sub-section (2) of section 33 and, whilst the holding is so reduced, the proviso to that sub-section shall cease to be operative.

(2) In respect of any period during which the holding of gold coin, gold bullion and securities of a sterling standard country is reduced under sub-section (1), the Bank shall pay to the Governor General in Council a tax upon the amount by which such holding is reduced below the minimum prescribed by sub-section (2) of section 33; and such tax shall be payable at the bank rate for the time being in force, with an addition of one per cent. per annum when such holding exceeds thirty-two and a half per cent. of the total amount of the assets and of a further one and a half per cent. per annum in respect of every further decrease of two and a half per cent. or part of such decrease:

Provided that the tax shall not in any event be payable at a rate less than six per cent. per annum.

38. The Governor General in Council shall undertake not to re-issue any rupee coin delivered under section 36 nor to put into circulation any new rupees, except through the Bank and as provided in that section; and the Bank shall undertake not to dispose of rupee coin otherwise than for the purposes of circulation or by delivery to the Governor General in Council under that section.

Obligations of the Government and the Bank in respect of rupee coin.

39. The Bank shall issue rupee coin on demand in exchange for currency notes of the Government of India, and shall issue currency notes or bank notes on demand in exchange for coin which is legal tender under the Indian Coinage Act, 1906, and it shall, in exchange for currency notes or bank notes of five rupees or upwards, supply currency notes or bank notes of lower value or rupees or other coins which are legal tender under the Indian Coinage Act, 1906, in such quantities as may, in the opinion of the Bank, be required for circulation; and the Governor General in Council shall, subject to the provisions of section 36, supply such rupees or coins to the Bank on demand. If the Governor General in Council at any time fails to discharge this duty, the Bank shall be released from its obligations to supply such coins to the public.

40. (1) The Bank shall sell, to any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras or Rangoon and pays the purchase price in legal tender currency, sterling for immediate delivery in London, at a rate not below one shilling and five pence and forty nine sixty-fourths of a penny for a rupee:

Provided that no person shall be entitled to demand to buy an amount of sterling less than ten thousand pounds.

41. The Bank shall buy, from any person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi, Madras or Rangoon, sterling for immediate delivery in London, at a rate not higher than one

Obligation to buy
sterling.

shilling and six pence and three-sixteenths of a penny for a rupee:

Provided that no person shall be entitled to demand to buy an amount of sterling less than ten thousand pounds.

42. (1) Every bank included in the Second Schedule shall maintain a balance with the

Cash reserves of Reserve Bank the amount of which scheduled banks to shall at no time be less than seven and be kept with the one-half per cent. of the daily average Bank.

of the demand, and two and one-half per cent. of the daily average of the

time liabilities of such bank in India.

(2) For the purpose of sub-section (1), the daily average of the amounts of the demand and time liabilities of each scheduled bank shall be computed in respect of each period ending on the fifteenth and on the last day of each month.

(3) Every such bank shall send to the Governor General in Council and to the Bank a monthly return, signed by two responsible officers of such bank, showing—

(a) the amounts of its demand and time liabilities respectively in India,

(b) the total amount held in India in currency notes of the Government of India and bank notes,

(c) the amounts held in India in rupee coin and subsidiary coin respectively,

(d) the amounts of advances made and of bills discounted in India respectively, and

(e) the balance held at the Bank,

at the close of the month to which the return relates.

(4) Every such return shall be sent not later than fourteen days after the close of the month to which it relates, and shall state whether the bank has during that month maintained with the Reserve Bank of minimum balance required by sub-section (1).

(5) Any bank failing to comply with the provisions of sub-section (3) or sub-section (4) shall be liable, on application made by or on behalf of the Governor General in Council to the principal Civil Court having jurisdiction in a place where an office of the bank is situated, to a penalty of one hundred rupees for each day during which the failure continues.

(6) When it appears from any such monthly return or from a report of the Central Board that any scheduled bank has failed to maintain the minimum balance required by sub-section (1), the Governor General in Council may call for such further return, or make such inspection of the books and accounts of that bank, as may be necessary to ascertain the amount of the deficiency, if any, and the period during which it has continued; and a bank so in default shall be liable, on application made by or on behalf of the Governor General in Council to the principal Civil Court having jurisdiction in a place where an office of the bank is situated, to a penalty at a rate per annum which shall be three per cent. above the bank rate on the amount of the deficiency for each day during which the default has continued, and shall be raised to five per cent. above the bank rate after the first seven days of the deficiency.

(7) The Governor General in Council shall, by notification in the Gazette of India, direct the inclusion in the Second Schedule of any company, not already so

included, which carries on the business of banking in British India and which—

- (a) is a company as defined in clause (2) of section 2 of the Indian Companies Act, 1913, or a corporation or company incorporated by or under any law in force in any place outside British India, and
- (b) has a paid up capital and reserves of an aggregate value of not less than three lakhs of rupees;

and shall by like a notification, direct the exclusion from that Schedule of any scheduled bank the aggregate value of whose paid-up capital and reserves at any time becomes less than three lakhs of rupees, or which goes into liquidation or otherwise ceases to carry on banking business.

43. The Bank shall enter into an agreement with the Imperial Bank of India which shall be subject to the approval of the Governor General in Council, and shall be expressed to come into force on the date on which this Chapter comes into force and to remain in force for twenty-five years, and shall further contain the provisions set forth in the Third Schedule.

CHAPTER IV. GENERAL PROVISIONS.

44. After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds, and such other contingencies as are usually provided for by bankers, and after payment out of the net

annual profits of a cumulative dividend at such rate not exceeding five per cent. per annum on the share capital as the Governor General in Council may fix at the time of the issue of shares, the surplus shall be allocated as follows:—

- (a) one-half to a Reserve Fund, until such Reserve Fund is equal to one-half of the share capital, and the remaining one-half to the Governor General in Council;
- (b) thereafter, until the Reserve Fund is equal to the share capital, one-tenth to the Reserve Fund, and the balance to the Governor General in Council; and
- (c) when and for so long as the Reserve Fund is not less than the share capital, a portion to an additional dividend to the shareholders calculated on the scale set forth in the Fourth Schedule, and the balance to the Governor General in Council:

Provided that, so long as the Reserve Fund is less than the share capital, not less than fifty lakhs of rupees of the surplus, or the whole of the surplus if less than that amount, shall be allocated to the Reserve Fund.

45. The Bank shall make public from time to time

Publication of
bank rate.

the minimum rate at which it is prepared to buy or re-discount bills of exchange or other commercial paper

eligible for purchase under this Act.

46. (1) Not less than two auditors shall be elected and their remuneration fixed at the annual general meeting. The auditors may be shareholders, but no Director or other officer of the Bank shall be eligible during his continuance in office.

Auditors.

Any auditor shall be eligible for re-election on quitting office.

(2) The first auditors of the Bank may be appointed by the Central Board before the first annual general meeting and, if so appointed, shall hold office only until that meeting. All auditors elected under this section shall severally be, and continue to act as, auditors until the first annual general meeting after their respective elections:

Provided that any casual vacancy in the office of any auditor elected under this section may be filled by the Central Board.

47. Without prejudice to anything contained in section 46, the Governor General in Council may at any time appoint such auditors as he thinks fit to examine and report upon the accounts of the Bank.

48. (1) Every auditor shall be supplied with a copy of the annual balance sheet, and it shall be his duty to examine the same, together with the accounts and vouchers relating thereto; and every auditor shall have a list delivered to him of all books kept by the Bank, and shall at all reasonable times have access to the books, accounts and other documents of the Bank, and may at the expense of the Bank if appointed by it or at the expense of the Governor General in Council if appointed by him, employ accountants or other persons to assist him in investigating such accounts, and may, in relation to such accounts, examine any Director or officer of the Bank.

(2) The auditors shall make a report to the share-

**Appointment of
special auditors by
Government.**

**Powers and duties
of auditors.**

holders or to the Governor General in Council, as the case may be, upon the annual balance-sheet and accounts and in every such report they shall state whether, in their opinion, the balance-sheet is a full and fair balance-sheet containing all necessary particulars and properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs, and, in case they have called for any explanation or information from the Central Board, whether it has been given and whether it is satisfactory. Any such report made to the shareholders shall be read, together with the report of the Central Board, at the annual general meeting.

49 (1) The Bank shall prepare and transmit to the Governor General in Council a weekly Returns. account of the Issue Department and of the Banking Department in the form set out in the Fifth Schedule or in such other form as the Governor General in Council may, by notification in the Gazette of India, prescribe. The Governor General in Council shall cause these accounts to be published weekly in the Gazette of India.

(2) The Bank shall also, within two months from the date on which the annual accounts of the Bank are closed, transmit to the Governor General in Council a copy of the annual accounts signed by the Governor, the Deputy Governors and the Chief Accounting Officer of the Bank, and certified by the auditors, and the Governor General in Council shall cause such accounts to be published in the Gazette of India.

(3) The Bank shall also, within two months from the date on which the annual accounts of the Bank are closed, transmit to the Governor General in Council a statement showing the name, address and occupation of,

and the number of shares held by, each shareholder of the Bank.

50. (1) The Local Board of any area may at any time require any shareholder who is registered on the Register for that area to furnish to the Local Board within a specified time, not being less than thirty days, a declaration, in such form as the Central Board may by

regulations prescribe, giving particulars of all shares on the said Register of which he is the owner.

(2) If it appears from such declaration that any shareholder is not the owner of any shares which are registered in his name, the Local Board may amend the Register accordingly.

(3) If any person required to make a declaration under sub-section (1) fails to make such declaration within the specified time, the Local Board may make an entry against his name in the Register recording such failure and directing that he shall have no right to vote, either under section 9 or section 14, by reason of the shares registered in his name on that Register.

(4) Whoever makes a false statement in any declaration furnished by him under sub-section (1) shall be deemed to have committed the offence of giving false evidence defined in section 191 of the Indian Penal Code, and shall be punishable under the second paragraph of section 192 of that Code.

51. (1) Nothing in the Indian Companies Act, 1913, shall apply to the Bank, and the
 Liquidation of the Bank shall not be placed in voluntary or compulsory liquidation save with the sanction of the Governor General in Council and in such

(2) In such event the Reserve Fund and surplus assets, if any, of the Bank shall be divided between the Governor General in Council and the shareholders in the proportion of seventy-five per cent. and twenty-five per cent., respectively.

52. (1) The Central Board may, with the previous sanction of the Governor General in Council, make regulations consistent with this Act to provide for all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of this Act.

Power of the Central Board to make regulations.

(2) In particular and without prejudice to the generality of the foregoing provision, such regulations may provide for all or any of the following matters, namely:—

- (a) the holding and conduct of elections under this Act, including, if the Central Board thinks fit, provisions for the holding of any elections according to the principle of proportional representation by means of the single transferable vote;
- (b) for the final decision of doubts or disputes regarding the qualifications of candidates for election or regarding the validity of elections;
- (c) the maintenance of the share register, the manner in which and the conditions subject to which shares may be held and transferred and, generally, all matters relating to the rights and duties of shareholders;
- (d) the manner in which general meetings shall be convened, the procedure to be followed

thereat and the manner in which votes may be exercised;

- (e) the manner in which notices may be served on behalf of the Bank upon shareholders or other persons;
- (f) the manner in which the business of the Central Board shall be transacted, and the procedure to be followed at meetings thereof;
- (g) the conduct of business of Local Boards and the delegation to such Boards of powers and functions.
- (h) the delegation of powers and functions of the Central Board to the Governor, or to Deputy Governors, Directors or officers of the Bank;
- (i) the formation of committees of the Central Board, the delegation of powers and functions of the Central Board to such Committees, and the conduct of business in such Committees;
- (j) the constitution and management of staff and superannuation funds for the officers and servants of the Bank;
- (k) the manner and form in which contracts binding on the Bank may be executed;
- (l) the provision of an official seal of the Bank and the manner and effect of its use;
- (m) the manner and form in which the balance sheet of the Bank shall be drawn up, and in which the accounts shall be maintained;
- (n) the circumstances in which, and the conditions and limitations subject to which, the

value of any lost, stolen, mutilated or imperfect currency note of the Government of India or bank note may be refunded; and (o) generally, for the efficient conduct of the business of the Bank.

53. In the Indian Coinage Act, 1906, for section III of 1906 the following section shall be substituted, namely:—

“11. Gold coins, coined at His Majesty’s Royal Mint in England or at any mint established in pursuance of a proclamation of His Majesty as a branch of His Majesty’s Royal Mint, shall not be legal tender in British India in payment or on account, but such coins shall be received by the Reserve Bank of India at the bullion value of such coins calculated at the rate of 8.47512 grains troy of fine gold per rupee.”

54. The Indian Paper Currency Act, 1923, the Indian Paper Currency (Amendment) Act, 1923, the Indian Paper Currency (Amendment) Act, 1925, and the Currency Act, 1927, are hereby repealed.

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